

**UNIVERSITY VILLAGE AT SHEPPARD PRATT,
A PROJECT OF MARYLAND ECONOMIC
DEVELOPMENT CORPORATION**

**Management's Discussion and
Analysis and Financial Statements
Together With Independent Auditors' Report**

For the Years Ended June 30, 2011 and 2010

**UNIVERSITY VILLAGE AT SHEPPARD PRATT,
A PROJECT OF MARYLAND ECONOMIC
DEVELOPMENT CORPORATION (MEDCO)**

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UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2011 and 2010

As management of University Village at Sheppard Pratt (the Project), a project of Maryland Economic Development Corporation (MEDCO), we offer readers of the Project's financial statements this narrative overview and analysis of the financial activities of the Project for the fiscal years ended June 30, 2011 and 2010. Management's Discussion and Analysis (MD&A) is designed to (a) assist the reader in focusing on significant financial issues, (b) provide an overview of the Project's financial activities, and (c) identify changes in the Project's financial position. We encourage readers to consider the information presented here in conjunction with the Project's financial statements and accompanying notes.

Financial Highlights

The financial highlights of the Project for the year ended June 30, 2011 were as follows:

- The liabilities of the Project exceeded its assets as of June 30, 2011 by \$9,018,000 (net deficit) as a result of cumulative excesses of net non-operating expenses, primarily interest expense, over operating income on an annual basis since the Project opened.
- The Project has met the Release Test in the trust indenture for distribution of excess cash and will be making a payment on accrued ground rent in fiscal year 2012.
- The Project incurred \$94,000 of capital asset expenditures primarily on replacement furniture and carpeting in the units and installation of sidewalks in previously unpaved high traffic areas. Management anticipates continuing expenditures to replace and renew additional capital assets each year in the future. A reserve fund held by the bond trustee has \$270,000 dedicated to these expenditures (See Note 2 to the financial statements).

The financial highlights of the Project for the year ended June 30, 2010 were as follows:

- The liabilities of the Project exceeded its assets as of June 30, 2010 by \$8,351,000 (net deficit) as a result of cumulative excesses of net non-operating expenses, primarily interest expense, over operating income on an annual basis since the Project opened.
- The Project met the Release Test in the trust indenture for distribution of excess cash and made a payment on accrued ground rent in fiscal year 2011.
- The Project incurred \$80,000 of capital asset expenditures primarily on replacement furniture and carpeting in the units. Management anticipates continuing expenditures to replace and renew additional capital assets each year in the future. A reserve fund held by the bond trustee had \$233,000 dedicated to these expenditures (See Note 2 to the financial statements).

Overview of the Financial Statements

This MD&A is intended to serve as an introduction to the Project's financial statements. The Project is intended to be a self-supporting entity and follows enterprise fund reporting; accordingly, the financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Enterprise fund statements offer short-term and long-term financial information about the activities and operations of the Project. These statements are presented in a manner similar to a private business such as a commercial real estate project. The Project's statements consist of two parts: the financial statements and notes to the financial statements.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2011 and 2010

The Financial Statements

The Project's financial statements are designed to provide readers with a broad overview of its finances, in a manner similar to a private-sector business.

The balance sheets present information on all of the Project's assets and liabilities, with the difference between the two reported as net deficit. MEDCO issued limited obligation revenue bonds to provide capital financing for construction of student housing on the grounds of Sheppard Pratt Hospital. The proceeds were deposited with a trustee and invested, generally in United States government or agency securities, guaranteed investment contracts or repurchase agreements, until disbursed for the acquisition or construction of capital assets or retained as certain required reserves. The revenue bonds were issued in MEDCO's name; however, MEDCO has no obligation for the bonds beyond the resources of the Project.

The statements of revenues, expenses and changes in net deficit present the operating activities of the Project and sources of non-operating revenues and expenses.

The statements of cash flows present summarized sources and uses of funds for the Project. Cash flows from operating activities generally represent the results of leasing and operating the Project, exclusive of interest income and expense. Cash flows from capital and related financing and investing activities generally reflect the incurrence of debt obligations, the subsequent investment of debt proceeds in the Project, periodic principal and interest payments on the debt and earnings on investments.

The Project is owned by MEDCO; however, at the end of the ground lease, ownership of the Project will revert to Sheppard Pratt Health System, Inc. (SPHSI).

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 11 – 21 of this report.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2011 and 2010

Financial Analysis of University Village at Sheppard Pratt

The following table summarizes the Project's financial position as of June 30:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current assets	\$ 2,171,774	\$ 2,243,284	\$ 2,443,643
Net capital assets	19,169,002	20,085,852	21,005,215
Other assets	<u>5,287,736</u>	<u>4,942,133</u>	<u>4,862,697</u>
Total Assets	<u>\$ 26,628,512</u>	<u>\$ 27,271,269</u>	<u>\$ 28,311,555</u>
Current liabilities	\$ 8,919,777	\$ 8,246,234	\$ 7,910,136
Non-current liabilities	<u>26,726,864</u>	<u>27,376,360</u>	<u>27,999,242</u>
Total Liabilities	<u>\$ 35,646,641</u>	<u>\$ 35,622,594</u>	<u>\$ 35,909,378</u>
Invested in capital assets, net of related debt	\$ (6,710,434)	\$ (6,348,191)	\$ (5,963,584)
Restricted net deficit	<u>(2,307,695)</u>	<u>(2,003,134)</u>	<u>(1,634,239)</u>
Total Net Deficit	<u>\$ (9,018,129)</u>	<u>\$ (8,351,325)</u>	<u>\$ (7,597,823)</u>

Significant factors in the changes in the Project's financial position as of June 30, 2011 include:

- Capital assets decreased \$917,000 primarily as a result of \$1,011,000 of depreciation, partially offset by \$94,000 of capital expenditures.
- Current liabilities increased \$674,000 primarily from a \$571,000 increase in accrued ground rent and a \$116,000 increase in accounts payable and other accrued expenses.
- Non-current liabilities decreased by \$649,000 from payments of principal on the Project's bonds, note payable and capital lease.
- Net deficit increased \$667,000 as a result of the excess of the Project's net non-operating expense of \$1,800,000 over operating income of \$1,133,000.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2011 and 2010

Financial Analysis of University Village at Sheppard Pratt – continued

Significant factors in the changes in the Project's financial position as of June 30, 2010 include:

- Capital assets decreased \$919,000 primarily as a result of \$1,000,000 of depreciation, partially offset by \$80,000 of capital expenditures.
- Current liabilities increased \$336,000 primarily from a \$386,000 increase in accrued ground rent and a \$59,000 increase in rents and fees collected in advance, partially offset by a \$131,000 decrease in accounts payable and other accrued expenses.
- Non-current liabilities decreased by \$623,000 from payments of principal on the Project's bonds, note payable and capital lease.
- Net deficit increased \$754,000 as a result of the excess of the Project's net non-operating expense of \$1,847,000 over operating income of \$1,093,000.

The following table summarizes the Project's revenues and expenses for the years ended June 30:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating Revenues:			
Apartment rentals	\$ 5,251,960	\$ 5,025,819	\$ 4,860,398
Service fees	271,385	254,574	254,262
Other	76,516	83,280	131,150
Total Operating Revenues	<u>5,599,861</u>	<u>5,363,673</u>	<u>5,245,810</u>
Operating Expenses:			
Property operating costs	1,359,403	1,346,354	1,444,005
Management and service fees	281,306	292,962	291,810
Administrative and general	119,494	125,663	123,717
Sales and marketing	32,054	16,780	11,372
Ground rent	1,663,661	1,489,130	1,323,248
Depreciation	1,010,864	999,573	963,325
Total Operating Expenses	<u>4,466,782</u>	<u>4,270,462</u>	<u>4,157,477</u>
Operating Income	1,133,079	1,093,211	1,088,333
Non-operating Expenses, net	<u>(1,799,883)</u>	<u>(1,846,713)</u>	<u>(1,858,602)</u>
Increase in Net Deficit	(666,804)	(753,502)	(770,269)
Net Deficit, beginning of year	<u>(8,351,325)</u>	<u>(7,597,823)</u>	<u>(6,827,554)</u>
Net Deficit, end of year	<u>\$ (9,018,129)</u>	<u>\$ (8,351,325)</u>	<u>\$ (7,597,823)</u>

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2011 and 2010

Financial Analysis of University Village at Sheppard Pratt – continued

Significant factors in the results for the year ended June 30, 2011 include:

- Occupancy ranged between 98.9% and 100% and averaged 99.6%.
- Operating revenues increased \$236,000 as a result of higher rental rates.
- Management and service fees decreased \$12,000 as a result of renegotiation of the management contract which provides for higher base fees but reduced incentives.
- Ground rent increased \$175,000 as a result of the annual 3% escalation in the lease and a \$141,000 increase in interest on deferred rents.

Significant factors in the results for the year ended June 30, 2010 include:

- Occupancy ranged between 98.7% and 100% and averaged 99.6%.
- Operating revenues increased \$118,000 as a result of higher rental rates.
- Property operating costs decreased \$98,000 as a result of a \$64,000 decrease in cable and internet service costs.
- Ground rent increased \$166,000 as a result of the annual 3% escalation in the lease and a \$133,000 increase in interest on deferred rents.

Capital Asset and Debt Administration

Capital Assets

In 2001, MEDCO was requested to assist in the development of a student housing project on the grounds of SPHSI through the issuance of its tax-exempt revenue bonds. The proceeds of the bonds were used for the initial design, construction and furnishing of the Project.

The most significant capital asset events during the year ended June 30, 2011 were the replacement of carpeting and certain furnishings and installation of sidewalks in previously unpaved high traffic areas totaling \$94,000. The most significant capital asset event during the year ended June 30, 2010 were the replacement of carpeting and certain furnishings totaling \$80,000.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Management's Discussion and Analysis For the Years Ended June 30, 2011 and 2010

Capital Asset and Debt Administration – continued

Debt

As of June 30, 2011 and 2010, the Project had total debt outstanding, net of unamortized bond discount, of \$27,384,000 and \$28,007,000, respectively. None of the bond or note debt totaling \$27,281,000 and \$27,872,000 at June 30, 2011 and 2010, respectively, is backed by the full faith and credit of the State of Maryland or MEDCO. The bond and note debt is secured solely by the revenues and assets of the Project. The capital lease debt of \$103,000 and \$135,000 at June 30, 2011 and 2010, respectively, is backed by MEDCO.

There were no major debt activities for the years ended June 30, 2011 and 2010.

Contacting Management of MEDCO

This report is designed to provide Maryland citizens and taxpayers, and our customers, clients, investors, and creditors, with a general overview of the finances of University Village at Sheppard Pratt. If you have questions about this report or need additional information, contact Maryland Economic Development Corporation, 100 North Charles Street, Suite 630, Baltimore, MD 21201.

Independent Auditors' Report

To the Board of Directors of
Maryland Economic Development Corporation:

We have audited the accompanying balance sheets of University Village at Sheppard Pratt (the Project), a project of Maryland Economic Development Corporation (MEDCO), as of June 30, 2011 and 2010, and the related statements of revenues, expenses, and changes in net deficit and cash flows for the years then ended. These financial statements are the responsibility of MEDCO's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Project's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the accompanying financial statements present only the financial position, changes in financial position and cash flows of the Project and do not purport to, and do not, present the financial position of MEDCO as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of University Village at Sheppard Pratt, a project of MEDCO, as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 1 through 6 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Stout, Causey & Horning, P.A.

September 7, 2011

**UNIVERSITY VILLAGE AT SHEPPARD PRATT,
A PROJECT OF MEDCO**

Balance Sheets

<i>As of June 30,</i>	<i>2011</i>	<i>2010</i>
Assets		
Current Assets:		
Cash and cash equivalents	\$ 208,489	\$ 229,890
Tenant security deposits	176,937	250,289
Deposits with bond trustee – restricted	1,687,329	1,685,275
Accounts receivable, net of allowance for doubtful accounts of \$10,000 and \$4,000, respectively	14,458	17,618
Interest receivable	48,881	48,606
Prepaid expenses and other assets	35,680	11,606
Total Current Assets	2,171,774	2,243,284
Non-current Assets:		
Deposits with bond trustee – restricted	3,717,983	3,286,240
Prepaid expenses	6,985	23,155
Capital assets:		
Buildings and improvements	24,646,933	24,612,411
Furnishings and equipment	3,308,363	3,297,288
	27,955,296	27,909,699
Less: Accumulated depreciation	8,786,294	7,823,847
Net Capital Assets	19,169,002	20,085,852
Deferred financing costs, net of accumulated amortization of \$684,296 and \$615,889, respectively	1,504,956	1,573,363
Prepaid issuer's fee	57,812	59,375
Total Non-current Assets	24,456,738	25,027,985
Total Assets	\$ 26,628,512	\$ 27,271,269
Liabilities and Net Deficit		
Current Liabilities:		
Accounts payable and other accrued expenses	\$ 247,732	\$ 131,526
Accrued interest	825,190	836,172
Rents and fees collected in advance	521,932	524,334
Tenant security deposits	245,950	272,450
Accrued ground rent	6,421,445	5,850,706
Bonds payable	495,000	470,000
Note payable	131,764	131,764
Capital lease	30,764	29,282
Total Current Liabilities	8,919,777	8,246,234
Non-current Liabilities:		
Bonds payable	24,118,258	24,602,497
Notes payable	2,536,448	2,668,212
Capital lease	72,158	105,651
Total Non-current Liabilities	26,726,864	27,376,360
Total Liabilities	35,646,641	35,622,594
Commitments (Note 5)		
Net Deficit:		
Invested in capital assets, net of related debt	(6,710,434)	(6,348,191)
Restricted net deficit	(2,307,695)	(2,003,134)
Total Net Deficit	(9,018,129)	(8,351,325)
Total Liabilities and Net Deficit	\$ 26,628,512	\$ 27,271,269

The accompanying notes are an integral part of these financial statements.

**UNIVERSITY VILLAGE AT SHEPPARD PRATT,
A PROJECT OF MEDCO**

Statements of Revenues, Expenses, and Changes in Net Deficit

<i>For the Years Ended June 30,</i>	<i>2011</i>	<i>2010</i>
Operating Revenues:		
Apartment rentals	\$ 5,251,960	\$ 5,025,819
Service fees	271,385	254,574
Other	76,516	83,280
Total Operating Revenues	5,599,861	5,363,673
Operating Expenses:		
Property operating costs	1,359,403	1,346,354
Management and service fees	281,306	292,962
Administrative and general	119,494	125,663
Sales and marketing	32,054	16,780
Ground rent	1,663,661	1,489,130
Depreciation	1,010,864	999,573
Total Operating Expenses	4,466,782	4,270,462
Operating Income	1,133,079	1,093,211
Non-operating Revenues (Expenses):		
Interest income	99,479	99,723
Interest expense	(1,899,362)	(1,946,436)
Total Non-operating Expenses, net	(1,799,883)	(1,846,713)
Increase in Net Deficit	(666,804)	(753,502)
Net Deficit, beginning of year	(8,351,325)	(7,597,823)
Net Deficit, end of year	\$ (9,018,129)	\$ (8,351,325)

The accompanying notes are an integral part of these financial statements.

**UNIVERSITY VILLAGE AT SHEPPARD PRATT,
A PROJECT OF MEDCO**

Statements of Cash Flows

<i>For the Years Ended June 30,</i>	<i>2011</i>	<i>2010</i>
Cash Flows from Operating Activities:		
Cash received from tenants	\$ 5,634,737	\$ 5,437,099
Cash paid for operating expenses	(2,762,580)	(3,002,923)
Net Cash Provided by Operating Activities	2,872,157	2,434,176
Cash Flows from Capital and Related Financing Activities:		
Construction, development and equipment expenditures	(94,014)	(78,710)
Capital lease proceeds	-	166,968
Principal payments on bonds payable	(470,000)	(450,000)
Principal payments on note payable	(131,764)	(131,764)
Principal payments on capital lease	(32,011)	(32,160)
Interest paid	(1,831,176)	(1,883,987)
Net Cash Used in Capital and Related Financing Activities	(2,558,965)	(2,409,653)
Cash Flows from Investing Activities:		
Net sales (purchases) of deposits with bond trustee - restricted	(433,797)	89,650
Interest received	99,204	100,270
Net Cash Provided by (Used in) Investing Activities	(334,593)	189,920
Net Increase (Decrease) in Cash and Cash Equivalents	(21,401)	214,443
Cash and Cash Equivalents, beginning of year	229,890	15,447
Cash and Cash Equivalents, end of year	\$ 208,489	\$ 229,890
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 1,133,079	\$ 1,093,211
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,010,864	999,573
Provision for doubtful accounts	12,734	5,999
Changes in operating assets and liabilities:		
Tenant security deposits	73,352	34,470
Accounts receivable	(9,574)	(18,553)
Prepaid expenses and other assets	(7,904)	(15,185)
Prepaid issuer's fee	1,563	1,563
Accounts payable and other accrued expenses	116,206	(131,203)
Rents and fees collected in advance	(2,402)	59,455
Tenant security deposits	(26,500)	19,054
Accrued ground rent	570,739	385,792
Net Cash Provided by Operating Activities	\$ 2,872,157	\$ 2,434,176
Non-cash capital and related financing activities:		
Amortization of deferred financing costs	\$ 68,407	\$ 68,407
Amortization of issue discount on bonds	10,761	10,761

The accompanying notes are an integral part of these financial statements.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RELATED MATTERS

Ownership and Management

University Village at Sheppard Pratt (the Project), located in Towson, Maryland, is a project of Maryland Economic Development Corporation (MEDCO). The Project consists of apartments with 615 beds and is located on land leased from Sheppard Pratt Health System, Inc. (SPHSI). The Project commenced operations in August 2002. Effective September 1, 2002, MEDCO entered into a management agreement with ACC SC Management, LLC (ACC) pursuant to which ACC provides certain management, leasing, and administrative services for the Project. The initial agreement expired August 31, 2004. The agreement was amended and extended in two-year intervals and expired August 31, 2010. A new agreement with ACC SC Management, LLC was entered into on September 1, 2010 and now expires September 1, 2013. The current agreement provides for a fixed fee of \$15,000 per month (the Fixed Fee Amount) and a variable fee equal to the amount by which 4.5% of "Gross Receipts", as defined, collected during the previous semester exceeds the sum of all Fixed Fee Amounts paid during such semester (the Variable Fee Amount), provided that in no event shall the Variable Fee Amount exceed the Fixed Fee Amount, plus reimbursement of certain other costs incurred in connection with operations of the Project.

The balance due for fees is included in accounts payable and other accrued expenses in the accompanying balance sheets and totaled \$105,344 and \$22,200 as of June 30, 2011 and 2010, respectively. Management fee expense was \$254,744 and \$266,400 for the years ended June 30, 2011 and 2010, respectively.

Pursuant to the trust indenture relating to the bonds payable, MEDCO is entitled to a service fee for administrative support and other services provided. The service fee was \$50,000 in each of the first two years and \$25,000 each year thereafter. Payment of the service fee is subordinated to payments of principal and interest required under the bonds payable. Service fee expense was \$26,562 for the years ended June 30, 2011 and 2010. There is no balance due to MEDCO for the service fee in the accompanying balance sheets.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RELATED MATTERS – continued

Basis of Presentation

The accompanying financial statements present the financial position, changes in financial position, and cash flows of the Project based on amounts specifically identifiable in MEDCO's accounting records. The Project is a project of MEDCO and, as such, all financial data presented herein is also included in the financial statements of MEDCO as of and for the years ended June 30, 2011 and 2010. However, the accompanying financial statements present only the Project and do not purport to, and do not, present the financial position of MEDCO as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. MEDCO utilizes the economic resources measurement focus and the accrual basis of accounting in preparing these financial statements, wherein revenues are recognized when earned and expenses are recognized when incurred. Also, in preparing these financial statements, MEDCO has adopted paragraph 6 of Statement No. 20 of the Governmental Accounting Standards Board (GASB), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, under which MEDCO has applied only the applicable Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless they conflict with GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses recognized during the reporting period. Actual results may differ from those estimates.

Cash and Cash Equivalents

Short-term investments with maturities of three months or less at date of purchase are classified as cash equivalents, except that any such investments purchased with funds on deposit with the bond trustee are classified with such deposits.

Through December 31, 2012 all non-interest bearing transaction accounts are fully insured, regardless of the balance of the account, at all Federal Deposit Insurance Corporation (FDIC) insured institutions. Interest bearing accounts at all FDIC insured institutions are insured up to \$250,000. Periodically, the Project's cash balances that are maintained with a single financial institution exceed the FDIC insured limits. Management believes this to be a normal business risk as the deposits are further protected through collateralization as described below.

The Project is required by Section 22(a) of Article 95 of the Annotated Code of Maryland to collateralize deposits in banks in excess of federal deposit insurance. Satisfactory collateral is enumerated at Section 6-202 of the State Finance and Procurement Article of the Annotated Code of Maryland. Bank deposits were properly collateralized as of June 30, 2011 and 2010.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RELATED MATTERS – continued

Tenant Security Deposits

Tenant security deposits are held in a checking account and represent tenant security deposits restricted under state law. Tenant security deposits were underfunded by \$69,013 and \$22,161 at June 30, 2011 and 2010, respectively. The differences result from the timing of receipts and refunds that are transacted in the operating account of the Project. Periodically, funds are transferred between cash and cash equivalents and tenant security deposits in order to meet the minimum funding requirements. Subsequent to year end, the tenant security deposits have been fully funded.

Accounts Receivable

Accounts receivable represent past due rent and various fees charged to residents. The Project provides an allowance for doubtful accounts based on the estimated collectability of resident accounts. Management's evaluation is based upon an analysis of past-due accounts and historical collection experience. The allowance for doubtful accounts totaled \$10,000 and \$4,000 as of June 30, 2011 and 2010, respectively. Accounts receivable are written off when it is determined that amounts are uncollectible.

Capital Assets and Depreciation

Capital assets are carried at cost including interest, carrying charges, salaries and related costs, and preconstruction costs associated with the development of the Project.

Capital assets are evaluated for impairment on an annual basis under GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* (GASB No. 42). GASB No. 42 requires an evaluation of prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. As of June 30, 2011 and 2010, management does not believe that the capital assets of the Project meet the criteria for impairment as set forth in GASB No. 42.

Depreciation of buildings and improvements is computed using the straight-line method over a useful life of 39 years. Furnishings and equipment are depreciated over 3 to 10 years using the straight-line method.

Deferred Financing Costs

Deferred financing costs represent the issuance and other costs associated with the issuance of the bonds. These costs are amortized to interest expense using the straight-line method over the term of the bonds, which is not materially different from the effective interest method.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND RELATED MATTERS – continued

Rents and Fees Collected in Advance

Rents and fees collected in advance represent amounts received for the future rental periods on leases in effect as of year-end.

Security Deposits Payable

As of June 30, 2011 and 2010, a security deposit was collected from each tenant. The security deposit is refunded to the tenant with interest upon termination of the lease if no damages or charges are outstanding on the tenant's account. Security deposits payable as of June 30, 2011 and 2010 totaled \$245,950 and \$272,450, respectively.

Net Deficit

Net deficit is presented as invested in capital assets, net of related debt or restricted net deficit. Net deficit invested in capital assets, net of related debt, represents the difference between capital assets, including deferred financing costs and related debt obligations. Restricted net deficit represents the difference between net deficit invested in capital assets, net of related debt and total net deficit, as all other funds are restricted as to their use under the terms of the trust indenture.

Revenue Recognition

The Project's revenues are derived primarily from leasing of apartments. Revenues are recognized monthly over the term of the respective leases.

Classification of Revenues and Expenses

Revenues and expenses related to the day-to-day activities of the Project are reported as operating revenues and expenses. Other revenues and expenses, consisting of interest income and interest expense, are reported as non-operating revenues and expenses.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were \$32,054 and \$16,780 for the years ended June 30, 2011 and 2010, respectively.

Income Taxes

MEDCO qualifies for tax-exempt status under Section 501(c)(4) of the Internal Revenue Code and Section 10-104 of the Tax-General Article of the Annotated Code of Maryland. Accordingly, no provision or benefit for income taxes is included in the accompanying financial statements.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

2. DEPOSITS WITH BOND TRUSTEE

Pursuant to the provisions of the trust indenture relating to the bonds payable (see Note 4), deposits with bond trustee include the following reserve funds and restricted accounts as of June 30:

	2011	2010
Current assets:		
Management fees fund	\$ 15,663	\$ 22,662
Operating reserve fund	323,535	323,499
Revenue fund	-	2
Interest fund	739,254	751,239
Subordinated debt fund	113,877	117,873
Principal fund	495,000	470,000
Current portion	1,687,329	1,685,275
Non-current assets:		
Repair and replacement fund	269,940	233,278
Surplus fund	1,471,943	1,076,861
Debt service reserve fund	1,976,100	1,976,101
Non-current portion	3,717,983	3,286,240
Total deposits with bond trustee	\$ 5,405,312	\$ 4,971,515

The trust indenture authorizes MEDCO or its trustee bank to invest the deposits as detailed under *Credit Risk* below. Interest earned on these investments was approximately \$99,000 and \$100,000 for the years ended June 30, 2011 and 2010, respectively. Investments of deposits with trustee are carried at fair value, except that non-participating investment contracts (i.e., contracts which are not able to realize market-based increase or decrease in value under any circumstance) are carried at cost. Investments of deposits with trustees are summarized as follows as of June 30:

	2011	2010
Repurchase agreement with HSBC Bank bearing interest at 5% and maturing on July 1, 2011	\$ 1,976,100	\$ 1,976,100
Money market funds	3,429,212	2,995,415
Total deposits with bond trustee	\$ 5,405,312	\$ 4,971,515

The repurchase agreement with HSBC Bank matures July 1, 2011 and is invested in money market funds. HSBC Bank was rated Aa2/AA and Aa3/AA by two major credit rating agencies as of June 30, 2011 and 2010, respectively.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

2. DEPOSITS WITH BOND TRUSTEE – continued

The deposits with bond trustee are subject to certain risks including the following:

Interest Rate Risk – The trustee has limited investments to money market and mutual funds that invest in U.S. government securities that can be liquidated at any time to meet the cash flow requirements of the Project and a fixed rate repurchase agreement that is guaranteed as to the face of the investment as a means of managing interest rate risk. As a result, the Project is not subject to interest rate risk.

Credit Risk – The Project's trust indenture limits MEDCO's investments to obligations of the United States of America (Government Obligations); certificates of deposit and time deposits with commercial banks, trust companies or savings and loan associations secured by Government Obligations; repurchase agreements for Government Obligations; investments in money market funds subject to SEC Rule 2a-7 consisting primarily of and secured by Government Obligations. As defined in the trust indenture, certain investments listed above must meet specific requirements to be a qualifying investment, such as high rating qualifications based on information from the major rating agencies, collateralization requirements, guaranteed repayment, and maturity requirements. The Project's investments were in compliance with these limitations as of June 30, 2011 and 2010.

Concentrations of Credit Risk – MEDCO's investment policy does not limit the amount that may be invested in any one issuer. The Project held no investments in commercial paper as of June 30, 2011 and 2010.

Custodial Risk – MEDCO is not subject to custodial risk because mutual funds are not evidenced by securities that exist in physical form and all other deposits are held in the Project's name.

The trust indenture requires the Project to set aside \$125 per bed per year increasing 3% per year from cash flows for future capital repairs and replacement of furnishings and equipment. These funds are to be segregated in a separate account within the trust. The repair and replacement fund was funded at its required balance as of June 30, 2011 and overfunded by \$15,558 as of June 30, 2010.

**UNIVERSITY VILLAGE AT SHEPPARD PRATT,
A PROJECT OF MEDCO**

**Notes to Financial Statements
For the Years Ended June 30, 2011 and 2010**

3. CAPITAL ASSETS

Capital assets activity for the years ended June 30, 2011 and 2010 is summarized as follows:

<u>2011</u>	<u>Beginning balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Buildings and improvements	\$ 24,612,411	\$ 34,522	\$ -	\$ 24,646,933
Furnishings and equipment	3,297,288	59,492	(48,417)	3,308,363
	27,909,699	94,014	(48,417)	27,955,296
Less: Accumulated depreciation:				
Buildings and improvements	(5,333,122)	(686,486)	-	(6,019,608)
Furnishings and equipment	(2,490,725)	(324,378)	48,417	(2,766,686)
	(7,823,847)	(1,010,864)	48,417	(8,786,294)
Net Capital Assets	<u>\$ 20,085,852</u>	<u>\$ (916,850)</u>	<u>\$ -</u>	<u>\$ 19,169,002</u>
<u>2010</u>	<u>Beginning balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Buildings and improvements	\$ 24,612,411	\$ -	\$ -	\$ 24,612,411
Furnishings and equipment	3,283,575	80,210	(66,497)	3,297,288
	27,895,986	80,210	(66,497)	27,909,699
Less: Accumulated depreciation:				
Buildings and improvements	(4,648,482)	(684,640)	-	(5,333,122)
Furnishings and equipment	(2,242,289)	(314,933)	66,497	(2,490,725)
	(6,890,771)	(999,573)	66,497	(7,823,847)
Net Capital Assets	<u>\$ 21,005,215</u>	<u>\$ (919,363)</u>	<u>\$ -</u>	<u>\$ 20,085,852</u>

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

4. LONG-TERM DEBT

Long-term debt consists of the following as of June 30:

	2011	2010
Bonds payable:		
Series 2001 Serial bonds bearing interest at rates ranging from 5.00% to 5.20% and maturing from July 1, 2008 through July 1, 2011	\$ 495,000	\$ 965,000
Series 2001 Term bonds bearing interest at rates ranging from 5.88% to 6.00% and payable in annual sinking fund installments from July 1, 2012 through July 1, 2033	24,355,000	24,355,000
Unamortized issue discount	(236,742)	(247,503)
Total bonds payable	24,613,258	25,072,497
Less: current portion	(495,000)	(470,000)
Non-current bonds payable	24,118,258	24,602,497
 Note payable to SPHSI:		
Note bearing interest at 12% with quarterly payments of principal and interest due from July 1, 2009 to July 1, 2031	2,668,212	2,799,976
Less: current portion	(131,764)	(131,764)
Non-current note payable	2,536,448	2,668,212
 Capital lease payable		
Capital lease bearing interest at 4.95% with monthly payments of principal and interest due from July 1, 2009 to June 1, 2014	102,922	134,933
Less: current portion	(30,764)	(29,282)
Non-current capital lease	72,158	105,651
Total non-current long-term debt	\$ 26,726,864	\$ 27,376,360

The bonds are secured by a deed of trust on the Project and a general assignment of related revenues and deposits in cash and cash equivalents, deposits with bond trustee, and capital assets (the Trust Estate). The bonds are limited obligations of MEDCO and are payable solely from the Trust Estate, as defined in the trust indenture. Interest on the bonds is payable semiannually on January 1 and July 1 and aggregated approximately \$1,479,000 and \$1,502,000 for the years ended June 30, 2011 and 2010, respectively. The issue discount is being amortized on a straight-line basis over the term of the bonds which is not materially different from the effective interest method. Payment of principal and interest on the bonds when due is guaranteed under an insurance policy issued by ACA Financial Guaranty Corporation (ACA). However, ACA's credit rating was downgraded several times during the financial market crisis. In its most recent rating, Standard & Poor's raised ACA's rating from CCC to B and then withdrew its rating at the request of ACA.

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

4. LONG-TERM DEBT – continued

In accordance with the trust indenture, the Project is required to produce a coverage ratio, as defined, of not less than 1.2 as of the last day of each fiscal year. The Project met the revenue coverage ratio as of June 30, 2011 and 2010.

The note payable to SPHSI is unsecured and related payments are subordinated to all payments required under the bonds payable trust indenture. The note is to be repaid over terms that commenced January 1, 2004 (after the Project reached stabilization, as defined in the loan agreement). Interest on the note totaled approximately \$331,000 and \$347,000 during the years ended June 30, 2011 and 2010, respectively.

Future payments on bonds and note payable debt are due as follows as of June 30, 2011:

Year ending June 30:	Total	Principal	Interest
2012	\$ 2,393,022	\$ 626,764	\$ 1,766,258
2013	2,371,293	651,763	1,719,530
2014	2,352,803	681,764	1,671,039
2015	2,337,256	716,763	1,620,493
2016	2,319,655	751,764	1,567,891
2017 – 2021	11,311,082	4,338,817	6,972,265
2022 – 2026	10,828,083	5,558,818	5,269,265
2027 – 2031	10,330,032	7,223,817	3,106,215
2032 – 2034	7,513,942	6,967,942	546,000
	<u>51,757,168</u>	<u>27,518,212</u>	<u>24,238,956</u>
Less: unamortized issue discount	(236,742)	(236,742)	-
	<u>\$ 51,520,426</u>	<u>\$ 27,281,470</u>	<u>\$ 24,238,956</u>

At June 30, 2011 and 2010, the Project was obligated under a capital lease agreement for equipment expiring in 2014. The cost of equipment under the capital lease is included in the accompanying balance sheets as furnishings and equipment and was \$167,093 at June 30, 2011 and 2010. Accumulated amortization of the leased equipment was \$83,547 and \$50,128 at June 30, 2011 and 2010, respectively. Amortization of assets under capital leases is included in depreciation expense.

**UNIVERSITY VILLAGE AT SHEPPARD PRATT,
A PROJECT OF MEDCO**

**Notes to Financial Statements
For the Years Ended June 30, 2011 and 2010**

4. LONG-TERM DEBT – continued

Future minimum payments under the agreement at June 30, 2011 are summarized as follows:

2012	\$	34,804
2013		37,968
2014		37,968
Total capital lease payments		110,740
Less: amounts representing interest		7,818
Present value of future minimum payments under capital lease obligations		\$ 102,922

Activity in bonds, note payable and capital leases for the years ended June 30, 2011 and 2010 is summarized as follows:

	Bonds Payable	Note Payable	Capital Lease
Balance June 30, 2009	\$ 25,511,736	\$ 2,931,740	\$ 167,093
Amortization of bond issue discount	10,761	-	-
Principal payments	(450,000)	(131,764)	(32,160)
Balance June 30, 2010	25,072,497	2,799,976	134,933
Amortization of bond issue discount	10,761	-	-
Principal payments	(470,000)	(131,764)	(32,011)
Balance June 30, 2011	\$ 24,613,258	\$ 2,668,212	\$ 102,922
Due within one year	\$ 495,000	\$ 131,764	\$ 30,764

UNIVERSITY VILLAGE AT SHEPPARD PRATT, A PROJECT OF MEDCO

Notes to Financial Statements For the Years Ended June 30, 2011 and 2010

5. GROUND LEASE

The land underlying the Project is leased from SPHSI under a non-cancelable operating lease expiring June 30, 2041. Rent payable under the lease totaled \$885,500 in the initial lease year (which commenced July 1, 2001), and increases by 3% each lease year thereafter. Payment of the rent is subordinated to all payments required under the bonds payable and related trust indenture. The trustees of SPHSI have waived interest on unpaid ground rent for the years ended June 30, 2004 through June 30, 2006. Unpaid ground rent for the years ended June 30, 2007, 2008, 2009, 2010 and 2011 bear interest at 12.65% annually beginning 90 days after the end of the related lease year. Ground rent expense totaled \$1,663,661 and \$1,489,130 for the years ended June 30, 2011 and 2010, respectively, including interest on unpaid ground rent of \$508,284 and \$367,406, respectively. Accrued ground rent totaled \$6,421,445 and \$5,850,706 as of June 30, 2011 and 2010, respectively, including accrued interest on unpaid ground rent of \$348,290 and \$293,608, respectively. Title to the operating facility improvements will revert to SPHSI upon termination of the lease. Future minimum rent payments are due as follows at June 30, 2011:

Year ending June 30:	
2012	\$ 7,611,000
2013	1,226,000
2014	1,263,000
2015	1,300,000
2016	1,339,000
2017 – 2021	7,325,000
2022 – 2026	8,491,000
2027 – 2031	9,843,000
2032 – 2036	11,411,000
2037 – 2041	13,229,000
	<u>\$ 63,038,000</u>

Payments for fiscal year 2011 include the accrued but unpaid rents for prior years of \$6,421,000.