

**FAYETTE SQUARE STUDENT HOUSING AT
UNIVERSITY OF MARYLAND, BALTIMORE,
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**

**FAYETTE SQUARE STUDENT HOUSING AT
UNIVERSITY OF MARYLAND, BALTIMORE,
A PROJECT OF MARYLAND ECONOMIC
DEVELOPMENT CORPORATION (MEDCO)**

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FAYETTE SQUARE STUDENT HOUSING AT UNIVERSITY OF MARYLAND, BALTIMORE, A PROJECT OF MEDCO

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

As management of Fayette Square Student Housing at University of Maryland, Baltimore, (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 activity, 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 \$9,425,000 (net deficit) as a result of cumulative excesses of operating and non-operating expenses, primarily depreciation and interest over operating income.
- Revenues have increased primarily due to an increase in the tenant rental rate.
- MEDCO and University of Maryland, Baltimore continue to cooperate by deferring the payment of specific expenses and the subordination of Capstone On-Campus Management, LLC's (Capstone) management fee.

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 \$8,557,000 (net deficit) as a result of cumulative excesses of operating and non-operating expenses, primarily depreciation and interest over operating income.
- Revenues have decreased primarily due to decreased occupancy that is attributable to an increase in rental rates and an over-supply of housing options in the immediate market.
- MEDCO and University of Maryland, Baltimore continue to cooperate by deferring the payment of specific expenses and the subordination of Capstone On-Campus Management, LLC's (Capstone) management fee.

FAYETTE SQUARE STUDENT HOUSING AT UNIVERSITY OF MARYLAND, BALTIMORE, A PROJECT OF MEDCO

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

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.

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 for University of Maryland, Baltimore. 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 operations of the Project, exclusive of interest income and expense. Cash flows from capital and related financing and investing activity 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 transfer to the University System of Maryland.

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.

FAYETTE SQUARE STUDENT HOUSING AT UNIVERSITY OF MARYLAND, BALTIMORE, A PROJECT OF MEDCO

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

Financial Analysis of Fayette Square Student Housing at University of Maryland, Baltimore

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

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current assets	\$ 1,289,853	\$ 1,185,026	\$ 1,622,016
Net capital assets	21,155,840	22,292,902	23,455,335
Other assets	<u>2,648,407</u>	<u>2,786,199</u>	<u>2,818,987</u>
Total Assets	<u>\$ 25,094,100</u>	<u>\$ 26,264,127</u>	<u>\$ 27,896,338</u>
Current liabilities	\$ 3,840,927	\$ 3,438,093	\$ 3,328,257
Bonds payable, less current portion	<u>30,678,130</u>	<u>31,383,495</u>	<u>31,993,860</u>
Total Liabilities	<u>\$ 34,519,057</u>	<u>\$ 34,821,588</u>	<u>\$ 35,322,117</u>
Invested in capital assets, net of related debt	\$ (10,343,676)	\$ (9,798,389)	\$ (9,137,730)
Restricted under trust indenture	<u>918,719</u>	<u>1,240,928</u>	<u>1,711,951</u>
Total Net Deficit	<u>\$ (9,424,957)</u>	<u>\$ (8,557,461)</u>	<u>\$ (7,425,779)</u>

Significant factors in the changes in the Project's financial position for the year ended June 30, 2011 include:

- Current assets increased \$105,000 primarily due to an increase in cash and cash equivalents, offset by a decrease in restricted trustee deposits.
- Net capital assets decreased \$1,137,000 due to current year depreciation.
- Total liabilities decreased \$303,000 primarily due to the payment of bond principal, offset by an increase in accounts payable and other accrued expenses and advances from University of Maryland, Baltimore.
- Net deficit increased \$867,000 as a result of the excess of net non-operating expenses of \$1,866,000 over the Project's operating income of \$999,000.

**FAYETTE SQUARE STUDENT HOUSING AT
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**Management's Discussion and Analysis
For the Years Ended June 30, 2011 and 2010**

**Financial Analysis of Fayette Square Student Housing at University of Maryland,
Baltimore – continued**

Significant factors in the changes in the Project's financial position for the year ended June 30, 2010 include:

- Current assets decreased \$437,000 primarily due to a decrease in cash flows from operations.
- Net capital assets decreased \$1,162,000 primarily due to current year depreciation.
- Non-current liabilities decreased \$610,000 primarily due to the payment of bond principal.
- Net deficit increased \$1,132,000 as a result of the excess of net non-operating expenses of \$1,892,000 over the Project's operating income of \$760,000.

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	\$ 3,642,976	\$ 3,506,003	\$ 3,782,725
Service fees	197,347	190,296	203,384
Other	43,054	13,920	17,502
Total Operating Revenues	<u>3,883,377</u>	<u>3,710,219</u>	<u>4,003,611</u>
Operating expenses:			
Property operating costs	1,411,827	1,373,430	1,342,331
Management and service fees	208,800	223,593	217,867
Administrative and general	106,009	154,584	92,548
Sales and marketing	20,841	14,791	10,198
Depreciation	1,137,062	1,183,914	1,455,552
Total Operating Expenses	<u>2,884,539</u>	<u>2,950,312</u>	<u>3,118,496</u>
Operating Income	998,838	759,907	885,115
Non-operating Expenses, net	<u>(1,866,334)</u>	<u>(1,891,589)</u>	<u>(1,867,687)</u>
Increase in Net Deficit	<u>\$ (867,496)</u>	<u>\$ (1,131,682)</u>	<u>\$ (982,572)</u>

FAYETTE SQUARE STUDENT HOUSING AT UNIVERSITY OF MARYLAND, BALTIMORE, A PROJECT OF MEDCO

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

Financial Analysis of Fayette Square Student Housing at University of Maryland, Baltimore – continued

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

- Occupancy ranged from 82% to 93% and averaged 90% for the 2010-2011 academic year.
- Operating revenues increased by \$173,000 due primarily due to an increase in the tenant rental rate.
- Operating expenses decreased \$66,000 primarily due to a decrease in administrative and general expenses and depreciation of \$49,000 and \$47,000, respectively.

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

- Occupancy ranged from 69% to 85% and averaged 84% for the 2009-2010 academic year.
- Operating revenues decreased \$293,000 due to a decrease in occupancy attributable to the increase in rental rates and an over-supply of housing options in the immediate market.
- Operating expenses decreased \$168,000 primarily due to a decrease in depreciation of \$272,000 offset by increases in consulting fees of \$38,000, legal expenses of \$13,000 and bad debt expense of \$11,000.

Capital Assets and Debt Administration

Capital Assets

In 2003, MEDCO was requested to assist in the development of a student housing project for University of Maryland, Baltimore through issuance of its tax-exempt revenue bonds. The proceeds of the bonds were used for the initial design, construction and furnishing of the Project.

There were no major capital asset events during the years ended June 30, 2011 and 2010.

**FAYETTE SQUARE STUDENT HOUSING AT
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**Management's Discussion and Analysis
For the Years Ended June 30, 2011 and 2010**

Capital Assets and Debt Administration - continued

Debt

As of June 30, 2011 and 2010, the Project had total bond debt outstanding, net of unamortized bond discount, of \$31,913,000 and \$32,523,000, respectively. None of this debt is backed by the full faith and credit of the State of Maryland or MEDCO. The debt is secured solely by the revenues and assets of the Project.

On January 1, 2007, \$510,000 of the Series B bonds became due and were not paid because the bonds are subordinate to the funding of operations, Series A debt service requirements, debt service reserve, repair and replacement fund and management fees.

There were no major debt events during 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 Fayette Square Student Housing at University of Maryland, Baltimore. 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 Fayette Square Student Housing at University of Maryland, Baltimore ("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 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 audits 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 the 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 Fayette Square Student Housing at University of Maryland, Baltimore, 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 1, 2011

**FAYETTE SQUARE STUDENT HOUSING AT
UNIVERSITY OF MARYLAND, BALTIMORE,
A PROJECT OF MEDCO**

<i>As of June 30,</i>	Balance Sheets	
	<i>2011</i>	<i>2010</i>
Assets		
Current Assets:		
Cash and cash equivalents	\$ 594,264	\$ 345,233
Deposits with bond trustee – restricted	656,751	805,675
Accounts receivable, net of allowance for doubtful accounts of \$14,096 and \$7,683, respectively	18,268	15,508
Interest receivable	25	29
Prepaid expenses	20,545	18,581
Total Current Assets	1,289,853	1,185,026
Non-current Assets:		
Deposits with bond trustee – restricted	2,182,179	2,296,627
Prepaid expenses	5,942	8,793
Capital assets		
Buildings and improvements	26,517,814	26,517,814
Furnishings and equipment	4,024,722	4,024,722
Total Capital Assets	30,542,536	30,542,536
Less: Accumulated depreciation	9,386,696	8,249,634
Total Non-current Assets	21,155,840	22,292,902
Deferred financing costs, net of accumulated amortization of \$156,464 and \$137,874, respectively	413,614	432,204
Prepaid issuer's fee	46,672	48,575
Total Non-current Assets	23,804,247	25,079,101
Total Assets	\$ 25,094,100	\$ 26,264,127
Liabilities and Net Deficit		
Current Liabilities:		
Accounts payable and other accrued expenses	\$ 1,091,843	\$ 963,623
Advances from University of Maryland, Baltimore	658,243	556,338
Accrued interest	725,920	694,364
Rents and fees collected in advance	129,921	83,768
Bonds payable	1,235,000	1,140,000
Total Current Liabilities	3,840,927	3,438,093
Non-current Liabilities:		
Bonds payable	30,678,130	31,383,495
Total Liabilities	34,519,057	34,821,588
Commitments (Note 5)		
Net Deficit:		
Invested in capital assets, net of related debt	(10,343,676)	(9,798,389)
Restricted under trust indenture	918,719	1,240,928
Total Net Deficit	(9,424,957)	(8,557,461)
Total Liabilities and Net Deficit	\$ 25,094,100	\$ 26,264,127

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

**FAYETTE SQUARE STUDENT HOUSING AT
UNIVERSITY OF MARYLAND, BALTIMORE,
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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	\$ 3,642,976	\$ 3,506,003
Service fees	197,347	190,296
Other	43,054	13,920
Total Operating Revenues	3,883,377	3,710,219
Operating Expenses:		
Property operating costs	1,411,827	1,373,430
Management and service fees	208,800	223,593
Administrative and general	106,009	154,584
Sales and marketing	20,841	14,791
Depreciation	1,137,062	1,183,914
Total Operating Expenses	2,884,539	2,950,312
Operating Income	998,838	759,907
Non-operating Revenues (Expenses):		
Interest income	340	567
Interest expense	(1,866,674)	(1,892,156)
Total Non-operating Expenses, net	(1,866,334)	(1,891,589)
Increase in Net Deficit	(867,496)	(1,131,682)
Net Deficit, beginning of year	(8,557,461)	(7,425,779)
Net Deficit, end of year	\$ (9,424,957)	\$ (8,557,461)

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

**FAYETTE SQUARE STUDENT HOUSING AT
UNIVERSITY OF MARYLAND, BALTIMORE,
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	\$ 3,916,106	\$ 3,657,587
Cash paid for operating expenses	(1,503,898)	(1,698,706)
Net Cash Provided by Operating Activities	2,412,208	1,958,881
Cash Flows from Capital and Related Financing Activities:		
Construction, development, and equipment expenditures	-	(21,481)
Bond principal payments	(630,000)	(540,000)
Interest paid	(1,796,893)	(1,821,081)
Net Cash Used in Capital and Related Financing Activities	(2,426,893)	(2,382,562)
Cash Flows from Investing Activities:		
Net sales of deposits with bond trustee	263,372	444,145
Interest received	344	568
Net Cash Provided by Investing Activities	263,716	444,713
Net Increase in Cash and Cash Equivalents	249,031	21,032
Cash and Cash Equivalents, beginning of year	345,233	324,201
Cash and Cash Equivalents, end of year	\$ 594,264	\$ 345,233
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating Income	\$ 998,838	\$ 759,907
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,137,062	1,183,914
Provision for doubtful accounts	10,664	7,585
Changes in operating assets and liabilities:		
Tenant security deposits	-	9,001
Accounts receivable	(13,424)	17,757
Prepaid expenses and issuer's fees	2,790	(6,269)
Accounts payable and other accrued expenses	128,220	193,556
Advances from University of Maryland, Baltimore	101,905	(127,180)
Rents and fees collected in advance	46,153	(75,115)
Tenant security deposits payable	-	(4,275)
Net Cash Provided by Operating Activities	\$ 2,412,208	\$ 1,958,881
Non-cash capital and related financing activities:		
Amortization of issue discount on bonds	\$ 19,635	\$ 19,635
Amortization of deferred financing costs	\$ 18,590	\$ 18,590

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

FAYETTE SQUARE STUDENT HOUSING AT UNIVERSITY OF MARYLAND, BALTIMORE, 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

Fayette Square Student Housing at University of Maryland, Baltimore (the Project), located in Baltimore City, Maryland, is a project of Maryland Economic Development Corporation (MEDCO). The Project consists of apartments with 337 beds and is located on land leased from the State of Maryland. The Project commenced operations in August 2004.

Effective February 12, 2003, MEDCO entered into a management agreement with A&R Management, Inc. (A&R) pursuant to which A&R provided certain management, leasing and administrative services for the Project. The agreement had a term of two years beginning July 1, 2004 and terminated February 28, 2006. It provided for a management fee of 5% of "rental revenues," as defined. One-half of the fee was paid in monthly installments and the other half of the fee was to be deposited with the bond trustee in the management fees fund and paid on the release date as defined in the trust indenture. Revenues of the Project in 2011 and 2010 were not sufficient to fund the management fees. Accounts payable related to this expense was \$126,237 at June 30, 2011 and 2010.

Effective March 1, 2006, MEDCO assigned the management agreement to Capstone On-Campus Management, LLC (Capstone). Capstone provides certain management, leasing and administrative services for the Project. The agreement provides for a monthly fee of \$15,000, with an increase of 3% per year beginning July 1, 2007.

Effective October 15, 2009, the management agreement was amended to provide that \$112,500 of the management fee would be payable as a non-deferred operating expense through September 30, 2010. Effective October 1, 2010, the management agreement was further amended to provide that the management fee would be \$14,583 per month through September 30, 2015, and would be paid as a non-deferred operating expense. Management fee expense under this agreement was \$181,898 and \$196,691 for the years ended June 30, 2011 and 2010, respectively. Accounts payable related to this expense was \$582,676 and \$560,153 at June 30, 2011 and 2010, respectively.

Pursuant to the trust indenture, MEDCO is entitled to an issuer's fee for administrative support and other services provided. The issuer's fee is \$50,000 for each of the first two years and \$25,000 each year thereafter. Payment of the issuer's fees is not subordinated to funding of the interest and principal accounts. Aggregate issuer's fees payable were \$150,000 and \$125,000 as of June 30, 2011 and 2010, respectively, and are included in accounts payable and other accrued expenses. Issuer's fee expense was \$26,902 for the years ended June 30, 2011 and 2010.

FAYETTE SQUARE STUDENT HOUSING AT UNIVERSITY OF MARYLAND, BALTIMORE, 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, the 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.

FAYETTE SQUARE STUDENT HOUSING AT UNIVERSITY OF MARYLAND, BALTIMORE, 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

Cash and Cash Equivalents - continued

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. As of June 30, 2011 and 2010, bank deposits were properly collateralized.

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 was \$14,096 and \$7,683 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 building and improvements is computed using the straight-line method over useful lives of 29 years and 15 years, respectively. Furnishings and equipment are depreciated over five to ten years using the straight-line method.

FAYETTE SQUARE STUDENT HOUSING AT UNIVERSITY OF MARYLAND, BALTIMORE, 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

Deferred Financing Costs

Deferred financing costs represent the issuance and other costs associated with obtaining 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.

Advances from University of Maryland, Baltimore

Advances from University of Maryland, Baltimore represent reimbursable expenses due to the University as of June 30, 2011 and 2010.

Rents and Fees Collected in Advance

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

Net Deficit

Net deficit is presented as either invested in capital assets, net of related debt or restricted under the trust indenture. Net deficit invested in capital assets, net of related debt, represents the difference between capital assets including deferred financing costs and the related debt obligations. Net deficit restricted under trust indenture 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 terms 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.

**FAYETTE SQUARE STUDENT HOUSING AT
UNIVERSITY OF MARYLAND, BALTIMORE,
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**

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were \$20,841 and \$14,791 during 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.

**FAYETTE SQUARE STUDENT HOUSING AT
UNIVERSITY OF MARYLAND, BALTIMORE,
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:

	<u>2011</u>	<u>2010</u>
Current assets:		
Revenue fund	\$ -	\$ -
Principal fund	\$ 359,173	\$ 420,003
Interest fund	297,252	385,346
Insurance fund	326	326
Current Portion	<u>656,751</u>	<u>805,675</u>
Non-current assets:		
Construction fund	3,392	3,392
Repair and replacement fund	1	1
Surplus fund	2	2
Debt service reserve fund	2,178,784	2,293,232
Non-current Portion	<u>2,182,179</u>	<u>2,296,627</u>
Total Deposits with Bond Trustee	<u>\$ 2,838,930</u>	<u>\$ 3,102,302</u>

Interest earned on these investments was \$340 and \$567 for the years ended June 30, 2011 and 2010, respectively.

Investments of deposits with trustee are carried at fair value and consisted of mutual funds as of June 30, 2011 and 2010.

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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 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. As a result, the Project is not subject to interest rate risk.

Credit Risk – The Project’s trust indenture limits MEDCO’s investments to government obligations; federal agencies obligations; certificates of deposit issued by and time deposits with commercial banks, trust companies, or savings and loan associations; repurchase agreements for government obligations; obligations issued by the Federal National Mortgage Association and Federal Home Loan Mortgage Corporation; senior debt obligations of the Federal Home Loan Bank System; commercial paper; U.S. dollar denominated deposit accounts; money market funds; public sector investment pools so long as MEDCO’s deposit does not exceed 5% of the aggregated pool balance at any time; pre-refunded municipal obligations, general obligations of states; or investment agreements. 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 at June 30, 2011 and 2010.

Concentration of Credit Risk – MEDCO’s investment policy does not limit the amount that may be invested in any one issuer except for public sector pool funds as described under Credit Risk above. The Project held no investments in public sector pool funds or 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.

The trust indenture requires the Project to fund the repair and replacement fund \$250 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 is underfunded by \$528,397 and \$430,366 at June 30, 2011 and 2010, respectively.

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**Notes to Financial Statements
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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	\$ 26,517,814	\$ -	\$ -	\$ 26,517,814
Furnishings and equipment	4,024,722	-	-	4,024,722
	30,542,536	-	-	30,542,536
Less accumulated depreciation:				
Buildings and improvements	(5,335,818)	(878,368)	-	(6,214,186)
Furnishings and equipment	(2,913,816)	(258,694)	-	(3,172,510)
	(8,249,634)	(1,137,062)	-	(9,386,696)
Net Capital Assets	<u>\$ 22,292,902</u>	<u>\$ (1,137,062)</u>	<u>\$ -</u>	<u>\$ 21,155,840</u>
<u>2010</u>	<u>Beginning balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending balance</u>
Buildings and improvements	\$ 26,517,814	\$ -	\$ -	\$ 26,517,814
Furnishings and equipment	4,003,241	21,481	-	4,024,722
	30,521,055	21,481	-	30,542,536
Less accumulated depreciation:				
Buildings and improvements	(4,457,449)	(878,369)	-	(5,335,818)
Furnishings and equipment	(2,608,271)	(305,545)	-	(2,913,816)
	(7,065,720)	(1,183,914)	-	(8,249,634)
Net Capital Assets	<u>\$ 23,455,335</u>	<u>\$ (1,162,433)</u>	<u>\$ -</u>	<u>\$ 22,292,902</u>

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4. BONDS PAYABLE

Bonds payable consist of the following as of June 30:

	2011	2010
Series 2003A Serial bonds bearing interest at rates ranging from 2.50% to 4.625% and maturing from October 1, 2009 through October 1, 2012	\$ 1,470,000	\$ 2,100,000
Series 2003A Term bonds bearing interest at rates ranging from 5.00% to 5.75% and payable in annual sinking fund installments from October 1, 2013 through October 1, 2033	30,370,000	30,370,000
Series 2003B bonds bearing interest at 7.5%, matured January 1, 2007	510,000	510,000
Unamortized issue discount	(436,870)	(456,505)
	31,913,130	32,523,495
Total bonds payable	31,913,130	32,523,495
Less current portion, Series A	(725,000)	(630,000)
Less current portion, Series B	(510,000)	(510,000)
Bonds payable, less current portion	\$ 30,678,130	\$ 31,383,495

The bonds are secured by a deed of trust on the Project and a general assignment of related revenues and deposits. They are limited obligations of MEDCO and are payable solely from the Project's revenues, as defined in the trust indenture. Interest on the bonds is payable semiannually on October 1 and April 1 and aggregated approximately \$1,797,000 and \$1,821,000 during the years ended June 30, 2011 and 2010, respectively. The issue discount is amortized over the term of the bonds.

The series 2003B bonds were issued to the developer of the Project in payment for services.

On January 1, 2007, the Series B bonds became due and were not paid because the bonds and interest payable are subordinated to the funding of operations, Series A debt service requirements, debt service reserve, repair and replacement fund and management fees. Interest continues to accrue on the outstanding Series B bonds.

In accordance with the trust indenture, the Project is required to produce a coverage ratio, as defined, of not less than 1.20 as of the last day of each fiscal year. The Project did not meet the coverage ratio as of June 30, 2011 and 2010. Under the terms of the trust indenture, MEDCO is required to promptly engage a management consultant to submit a written report and recommendations with respect to the operation of the Project. A consultant's management report for the year ended June 30, 2010 was received by MEDCO, University of Maryland, Baltimore and Capstone and the recommendations were followed. MEDCO will engage the services of a management consultant to submit a similar report for the year ended June 30, 2011.

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4. BONDS PAYABLE – continued

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

Year ending June 30:	<u>Total</u>	<u>Principal</u>	<u>Interest</u>
2012	\$ 2,484,038	\$ 1,235,000	\$ 2,039,082
2013	2,470,039	745,000	1,725,039
2014	2,471,988	785,000	1,686,988
2015	2,471,238	825,000	1,646,238
2016	2,473,300	870,000	1,603,300
2017 – 2021	12,339,375	5,140,000	7,199,375
2022 – 2026	12,324,772	6,825,000	5,499,772
2027 – 2031	12,282,175	9,080,000	3,202,175
2032 – 2035	7,352,222	6,845,000	507,222
	<u>56,669,147</u>	<u>32,350,000</u>	<u>25,109,191</u>
Less unamortized bond discount	(436,870)	(436,870)	-
	<u>\$ 56,232,277</u>	<u>\$ 31,913,130</u>	<u>\$ 25,109,191</u>

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

Balance June 30, 2009:	\$ 33,043,860
Amortization of bond issue discount	19,635
Principal payments	<u>(540,000)</u>
Balance June 30, 2010:	32,523,495
Amortization of bond issue discount	19,635
Principal payments	<u>(630,000)</u>
Balance June 30, 2011:	<u>\$ 31,913,130</u>
Due within one year	<u>\$ 1,235,000</u>

Payments due within one year include principal amounts of \$510,000 related to the Series 2003B bonds that were due on January 1, 2007.

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

5. GROUND LEASE

The land underlying the Project is leased from the State of Maryland on behalf of University of Maryland, Baltimore under a non-cancelable operating lease expiring on the earlier to occur of February 12, 2043 or the date on which the bonds have been fully repaid. Rent payable under the lease is equal to “net revenues,” as defined. Payment of the rent is subordinated to all payments required under the bonds payable and related trust indenture. Effective July 1, 2007, MEDCO entered into a Memorandum of Understanding with the University of Maryland, Baltimore. The terms of the Memorandum of Understanding include a cash basis calculation of ground rent expense and an evaluation of total ground rent due and accrued since the inception of the Project. No ground rent was due for the years ended June 30, 2011 and 2010.

The lease provides various conditions and restrictions on the use, operations and maintenance of the Project and provides the University System of Maryland, on behalf of University of Maryland, Baltimore, an option to purchase the Project improvements for a price of \$1 plus the outstanding balance of the bonds payable (or other permitted debt) at any time during the lease term. Title to the Project improvements will revert to the University System of Maryland upon termination of the lease.

In accordance with the Ground Lease Agreement, a Memorandum of Understanding effective July 2, 2003, and an Amended and Restated Memorandum of Understanding effective April 2, 2007, the Lessee (MEDCO) shall create, hold and maintain a single fund for all Projects, referred to in each Ground Lease as the operating reserve fund, to be held and used in accordance with each Ground Lease and Memorandum. From monies which otherwise would be rent, MEDCO is authorized to make, on behalf of the Projects, annual deposits to the operating reserve fund on or before November 30 of each year, in the amount of \$20,000 for each of the Bowie State University, Salisbury University and the University of Maryland, Baltimore Projects, and commencing in November 2009, \$20,000 for the Towson University Project, and commencing in November, 2011, \$40,000 for the University of Maryland, College Park Project, provided however, if the deposit of the full amount would cause the operating reserve fund to exceed the maximum amount per the Amended and Restated Memorandum of Understanding, the amount deposited under each ground lease shall be reduced proportionately. As of June 30, 2011 no deposits in lieu of ground rent have been made by the University of Maryland, Baltimore Project to the operating reserve fund due to the fact that the Project, since inception, has not incurred ground rent expense.