CAPITALIZE ALBANY CORPORATION

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

Year ended December 31, 2012

CAPITALIZE ALBANY CORPORATION

TABLE OF CONTENTS

UHY LLP
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Capitalize Albany Corporation

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Capitalize Albany Corporation (a component reporting unit of the City of Albany), which comprise the consolidated statement of net position as of December 31, 2012, and the related consolidated statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Capitalize Albany Corporation as of December 31, 2012, and the changes in their financial position and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 to 6 be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2013, on our consideration of Capitalize Albany Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Capitalize Albany Corporation's internal control over financial reporting and compliance.

UHY LLP

Albany, New York
March 25, 2013

CAPITALIZE ALBANY CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management Discussion and Analysis (MD&A) of Capitalize Albany Corporation (CAC or the Corporation) activities and financial performance, is offered as an introduction and overview of the consolidated financial statements of CAC for the fiscal year ended December 31, 2012. Following this MD&A are the basic consolidated financial statements of CAC together with the notes thereto which are essential to a full understanding of the data contained in the consolidated financial statements. In addition to the notes, this section also presents certain supplementary information to assist with the understanding of CAC's financial operations.

CAC has a Corporate Governance Policy which includes a conflict of interest policy and a conflict of interest disclosure. The conflict of interest disclosure is distributed to and completed by CAC's Board of Directors on an annual basis.

The Finance and Investment Committee meetings are held on a quarterly basis or more frequently if necessary to provide enhanced project and transactional analysis. As necessary, the Committee makes recommendations for the Board's consideration. On a monthly basis, the Board of Directors of CAC meets to discuss programming needs, project activity and progress, and meets quarterly to discuss CAC's financial position. In addition, the Audit Committee of the Board of Directors, without management present, independently meets with the external auditors to discuss relevant issues and concerns.

OPERATION SUMMARY

In 1979, the Capitalize Albany Corporation (formerly Albany Local Development Corporation) was incorporated to primarily provide financing to eligible businesses in order to create and retain employment and investment within the City of Albany. CAC continues to extend loans and plays an active role in facilitating large-scale transformational real estate projects that the Corporation has identified as a priority.

CAC executes the Capitalize Albany economic development strategy as well as implements the initiatives identified as part of the 2007 Re-Capitalize Albany Strategic Advisory Committee Report. The 2007 Report evaluated the existing economic development vision and recommended necessary updates and changes.

Business Development

CAC facilitates real estate transactions to expand and enhance business development and investment opportunities. Additionally, CAC encourages job creation and business development by extending loans to new and existing businesses, as well as providing technical support with respect to city, state and other economic development programs.

CAC administers and provides staffing, office equipment, phone and computer network support to the City of Albany Industrial Development Agency (CAIDA) and the City of Albany Capital Resource Corporation (CACRC). During 2012, several organizations utilized the programs and incentives of the CAIDA; resulting in approximately $30.9 million of new projects within the City of Albany. These projects are anticipated to create or retain approximately 550 jobs within the City of Albany.

Downtown Revitalization

In 2010, the Corporation's Board of Directors established a Real Estate Loan Fund designed to provide subordinate lending to qualifying borrowers at below market rates in concert with primary lenders for the purpose of stimulating strategic development projects. The Board allocated $2 million to capitalize the Fund which is focused on revitalizing strategic vacant or underutilized real estate that will contribute positive and transformational development activity. Three loans totaling $900,000 were disbursed in 2012 under this program.

The Downtown Albany Residential Conversion and Commercial Rehabilitation program, funded by NY Main Street Grant funds, has been developed to increase mixed-use development and add residential units in Downtown. The program will also enhance commercial and retail vitality in Downtown. During 2012, two projects received $300,000 under this program resulting in project investment in excess of $8 million.

FINANCIAL OPERATIONS HIGHLIGHTS

CAC facilitates the Capitalize Albany Economic Development Strategy. The projects associated with this strategy are diverse, and therefore CAC's activities fluctuate greatly from year to year. With such diversity, it is not always meaningful to compare revenue and expenditure levels to prior years. While revenues and expenditures for any given year represent activity during that year, one must consider the level of program revenue to program expenses within a given year, in relation to the projects undertaken and accomplished during that same year. A condensed summary of revenues and expenses for the years ended December 31, 2012, and 2011 is shown below:

	2012	2011
Total revenues	$ 1,834,542	$ 1,434,836
Total expenses	1,589,258	1,819,513
Excess of revenues over expenses (expenses over revenues)	$ 245,284	$ (384,677)

Total revenues increased $399,707 or 28%:

- Grant revenues increased $300,000 or 61% from $492,800 in 2011 to $792,800 in 2012. Revenue derived from grants is typically program specific and non-recurring. The increase is attributable to an increase in the economic development grant from the City of Albany IDA and the receipt of NY Main Street Grant funds from New York State. Main Street Grant funds are passed through directly to project developers. Accordingly, a comparable expense was recorded in 2012. Significant grants in 2012 include $250,000 from the IDA and $170,000 from the Albany Community Development Agency both for general economic development support.

- Rental income increased by $10,441 or 3%. This is primarily attributable to filling a prior year vacancy in a property owned by the Corporation.

- Other interest and investment income increased $70,684 or 35% from $200,837 in 2011 to $271,521 in 2012 primarily due to the change in fair market value on investments.

- Interest income on mortgage notes increased $20,985 or 30% from $70,451 in 2011 to $91,436 in 2012 due to the issuance of new loans.

- Fees and other income decreased $2,404 or 1% from $324,271 in 2011 to $321,867 in 2012. This is primarily attributable to the decrease in commitment fees and membership fees which were offset by increases in sponsorship revenue and administrative cost recoveries.

Total expenses decreased $230,255 or 13%:

- Salaries and fringe benefits decreased $141,648 or 22% from $650,175 in 2011 to $508,527 in 2012 due to the execution of a Professional Services Agreement with the City of Albany whereby the City of Albany provides professional services to the Corporation and subsequently costs under the agreement are classified as professional services expense paid to the City of Albany where in prior years they were salaries and fringe benefits.

- Program and project costs increased $261,789 or 100% from $261,610 in 2011 to $523,399 in 2012. The increase is primarily attributable to NY Main Street Grant activity that occurred in 2012 and not in 2011. This increased activity was offset by modest reductions in other various programming activities.

- Interest expense decreased $12,641 or 11% from $113,209 in 2011 to $100,568 in 2012. This decrease is attributable to reduced interest rate on the variable rate bonds that were issued to finance redevelopment projects supported by capital leases.

- Bad debt recoveries totaled $51,225 in 2012. Bad debt expenses totaled $463,455 in 2011 primarily attributable to recording an allowance for one non-performing loan.

- Other administrative expenses increased $176,925 or 53% from $331,064 in 2011 to $507,989 in 2012. This increase is attributable to the $160,000 fee under the Professional Services Agreement with the City of Albany effective January 1, 2012 (see offsetting cost reductions in salaries and fringe benefits) and modest increases in various administrative expenses.

A condensed summary of CAC's net position at December 31, 2012 and 2011 is shown below:

	2012	2011
Assets		
Cash and cash equivalents	$ 2,842,349	$ 3,572,020
Investments	2,745,164	2,644,806
Restricted cash	387,719	321,034
Other assets	972,992	800,464
Mortgage notes receivable, net of allowances	2,748,701	2,030,574
Net investment in direct financing leases	2,091,218	2,273,211
Property, plant and equipment, net (includes property held for investment and lease)	3,829,475	4,135,705
Total assets	$ 15,617,618	$ 15,777,814
Deferred Outflows of Resources	$ -	$ -
Liabilities		
Bonds payable	$ 4,208,436	$ 4,530,548
Other liabilities	1,058,762	1,138,760
Unearned program support and revolving loan fund liability	783,322	786,692
Total liabilities	$ 6,050,520	$ 6,456,000
Deferred Inflows of Resources	$ -	$ -
Net Position		
Net investment in capital assets	$ 1,454,474	$ 1,615,705
Restricted net position	293,037	289,781
Unrestricted net position	7,819,587	7,416,328
Total net position	$ 9,567,098	$ 9,321,814

CURRENT KNOWN FACTS, DECISIONS OR CONDITIONS

In 2013, CAC will continue to facilitate the Capitalize Albany Economic Development Strategy. As part of that strategy, the Corporation will continue to focus on developing more downtown residential capacity and will pursue opportunities that will result in catalytic development projects as well as maximize and diversify potential revenue sources for the Corporation.

Continual execution of the Strategic Plan established by the Corporation's Board in 2009 will translate into potential projects. New economic development opportunities with the potential to generate new resources to stimulate growth will be developed by re-focusing and deploying existing strengths and resources. Ultimately, programmatic, marketing, and financial initiatives will reconcile to the objectives set forth in the Strategic Plan.

In 2013, CAC will work to create a Downtown Tactical Plan. This Plan will identify opportunities for economic development and growth in Downtown through the development of new programs and initiatives. The Downtown Tactical Plan will focus on a variety of areas, including long-range vision, community engagement, and market driven recommendations and will act as a guide for local redevelopment and reinvestment in a manner that meets the needs of residents, businesses and other stakeholders. It will extend upon the broader-scoped Albany 2030 Plan as well as projects currently under development in the area such as Kiernan Plaza and its geographic scope will include the greater Downtown Albany area including the waterfront.

FINANCIAL STATEMENTS

CAC's financial statements are prepared on an accrual basis in accordance with U.S. generally accepted accounting principles promulgated by the Government Accounting Standards Board (GASB). CAC is organized under the Not-For-Profit Corporation laws of the State of New York. CAC is also a component reporting unit of the City of Albany. CAC follows enterprise fund accounting; accordingly, the financial statements are presented using the economic resources management focus. These financial statements are presented in a manner similar to a private business.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of CAC's finances for all those interested. Questions concerning any of the information provided in this report or request for additional information should be addressed in writing to the Vice President and Chief Financial Officer, Capitalize Albany Corporation, 21 Lodge Street, Albany, NY 12207.

CAPITALIZE ALBANY CORPORATION
CONSOLIDATED STATEMENT OF NET POSITION
December 31, 2012

	2012
Assets	
Current Assets:	
Cash and cash equivalents	$ 2,842,349
Investments	2,745,164
Restricted cash	387,719
Mortgage notes receivable, current portion, net	186,954
Net investment in direct financing leases, current portion	193,589
Accrued interest receivable	74,205
Grants receivable	62,500
Receivables from the City of Albany and City agencies	100,000
Total current assets	6,592,480
Noncurrent Assets:	
Mortgage notes receivable, less current portion, net	2,561,747
Other receivables	91,221
Net investment in direct financing leases, less current portion	1,897,629
Property held for investment and lease, net	3,371,656
Property and equipment, net	457,819
Other assets	645,066
Total noncurrent assets	9,025,138
Total assets	$ 15,617,618
Deferred Outflows of Resources	$ -
Liabilities	
Current Liabilities:	
Accounts payable and accrued expenses	$ 102,941
Due to the City of Albany	99,448
Unearned grant and other income	856,373
Bonds payable, current portion	339,846
Total current liabilities	1,398,608
Noncurrent Liabilities:	
Bonds payable, less current portion	3,868,590
Revolving loan fund liability	701,875
Unearned program support	81,447
Total noncurrent liabilities	4,651,912
Total liabilities	$ 6,050,520
Deferred Inflows of Resources	$ -
Net Position	
Net invested in capital assets	$ 1,454,474
Restricted for:	
Debt service	171,401
CDBG eligible activities	115,074
Other program specific activities	6,562
Unrestricted	7,819,587
Total net position	$ 9,567,098

See notes to consolidated financial statements.

CAPITALIZE ALBANY CORPORATION
CONSOLIDATED STATEMENT OF REVENUES AND EXPENSES AND CHANGES IN NET POSITION
For the Year Ended December 31, 2012

	2012
Revenues	
Grant income	$ 792,800
Rental income	356,918
Other interest and investment income	271,521
Interest income on mortgage notes	91,436
Fees and other income	321,867
Total revenues	1,834,542
Expenses	
Salaries and fringe benefits	508,527
Program and project costs	523,399
Interest expense	100,568
Bad debt (recovery) expenses	(51,225)
Other administrative expenses	507,989
Total expenses	1,589,258
Excess of revenues over expenses	245,284
Net Position, Beginning of Year	9,321,814
Net Position, End of Year	$ 9,567,098

See notes to consolidated financial statements.

CAPITALIZE ALBANY CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2012

	2012
Cash Flows From Operating Activities	
Cash received from customers	$ 607,547
Cash received from grantors	672,506
Other operating cash receipts	321,867
Cash payments to suppliers and grantees	(846,493)
Cash payments to employees	(508,527)
Net cash provided by operating activities	246,900
Cash Flows From Capital and Related Financing Activities	
Purchase of property and equipment	(16,950)
Purchase of other assets including purchase options	(525)
Principal payments on bonds payable	(322,112)
Interest paid on bonds payable	(102,772)
Net cash used in capital and related financing activities	(442,359)
Cash Flows From Investing Activities	
Interest on cash and cash equivalents and investments	75,380
Net (increase) decrease in restricted cash	(66,685)
Proceeds from sales and maturities of investments	2,323,619
Purchase of investments	(2,381,617)
Issuance of mortgage notes receivable	(900,000)
Repayments received on mortgage notes receivable	233,098
Principal payments received under direct financing leases	181,993
Net cash used in investing activities	(534,212)
Change in cash and cash equivalents	(729,671)
Cash and cash equivalents:	
Beginning of year	3,572,020
End of year	$ 2,842,349

See notes to consolidated financial statements.

CAPITALIZE ALBANY CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS, CONTINUED
For the Year Ended December 31, 2012

	2012
Reconciliation of Excess of Revenues Over Expenses to Net Cash Provided by Operating Activities	
Excess of revenues over expenses	$ 245,284
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:	
Depreciation and amortization	208,265
Adjustment for losses on mortgage notes and other receivables	(51,225)
Gain on sale of property	-
Net realized and unrealized losses (gains) on investments	(42,360)
Interest income on cash and cash equivalents and investments	(78,162)
Interest expense on bonds payable	100,568
Changes in:	
Grants receivable	(62,500)
Other receivables, accrued interest receivable and other assets	8,194
Accounts payable and accrued expenses	13,431
Due to the City of Albany	(36,800)
Unearned grant and other income	(54,425)
Revolving loan fund liability	(3,370)
Net cash provided by operating activities	$ 246,900

See notes to consolidated financial statements.

NOTE 1 — ORGANIZATION AND MISSION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Mission

Capitalize Albany Corporation (CAC) was formed under the Not-for-Profit Corporation Laws of the State of New York in October 1979 for the purposes of facilitating the creation of new employment opportunities, retaining existing jobs and encouraging investment that will expand the commercial and industrial tax base within the City of Albany (City). CAC facilitates large scale transformational real estate projects to accomplish its mission.

CAC's mission is accomplished by providing technical support for City, State and other economic development programs and loaning money to new or existing businesses. Additionally, CAC has invested in certain real estate, and leases such real estate to businesses in order to further job opportunities within the City.

CAC formed Citywide Property Holdings, LLC (Citywide) in April 2008 for the limited purpose of assisting CAC in the furtherance of CAC's mission. CAC is the sole member and manager of Citywide. Citywide's participation in the furtherance of CAC's mission is evaluated on a project basis. This participation includes, but is not limited to, holding property as available for sale to enhance project development.

The consolidated financial statements represent the consolidated financial position and the consolidated changes in financial position and cash flows of CAC and Citywide. All intercompany transactions between CAC and Citywide have been eliminated for the financial reporting purpose.

Component Unit Reporting

CAC is a component reporting unit of the City of Albany and, as such, is also reported in the City of Albany's general purpose financial statements.

Basis of Accounting and Presentation

CAC follows enterprise fund reporting; accordingly, the accompanying financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. CAC's consolidated financial statements apply all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as applicable Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Revenue Recognition

CAC, under Urban Development Action Grants (UDAG) financing arrangements through the United States Department of Housing and Urban Development (HUD), has recognized grant amounts as mortgage notes receivable, with corresponding credits to deferred program support. Principal repayments on these notes are recognized as program income and are applied against deferred program support. The UDAG agreements provide that the program income, together with the interest earned thereon, are restricted by HUD to be used for Title I eligible activities. The deferred program support account, in CAC's consolidated balance sheet, is a contra account which reflects UDAG loan principal repayments scheduled to be received in future years. There were no new UDAG grants in either 2012 or 2011.

NOTE 1 — ORGANIZATION AND MISSION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

Cash is comprised of various interest bearing and non-interest bearing deposits in several financial institutions. CAC considers all highly liquid investments with original maturities of three months or less to be cash equivalents except for cash equivalents included in the investment account, which are included in investments in the accompanying consolidated balance sheets.

Investments

Investments are carried at fair value, based on current market prices.

Mortgage Notes Receivable and Allowance for Losses

As explained further in Note 5, mortgage notes receivable are carried at the principal amount outstanding, net of an allowance for estimated uncollectible amounts. CAC's allowance for losses is evaluated on a regular basis by management and is estimated based on delinquency rates, current economic conditions, borrowers' outstanding balances, an analysis of borrowers' financial condition, and estimated value of any underlying collateral. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for losses is increased by provisions charged to earnings and reduced by charge-offs, net of recoveries.

Loans made by CAC to recipient entities are generally issued as part of larger financial packages involving additional lenders. Substantially all of CAC's mortgage notes receivable, which are collateralized by real property and/or equipment, are subordinated to the loans provided by these other lenders. In some cases, projected growth and overall economic conditions have substantially changed since loan origination. CAC attempts to work with borrowers who are experiencing financial difficulties and has entered into debt restructuring agreements with respect to certain financially troubled borrowers. These restructuring agreements often incorporate notes, for which current repayment is contingent upon favorable future events as specified in the note agreement. Such uncertainties have been considered by CAC in establishing the estimated allowance for possible losses.

CAC places impaired loans on nonaccrual status and recognizes interest income on such loans only on a cash basis. Accrual of interest is discontinued on a loan when management believes, after considering economics, business conditions, and collection efforts that the borrower's financial condition is such that collection of interest is doubtful. Uncollectible interest previously accrued is charged off. Income is subsequently recognized only to the extent cash payments are received until, in management's judgment, the borrower's ability to make periodic interest and principal payments is back to normal, in which case the loan is returned to accrual status.

Property Held for Investment and Lease, Net

Property held for investment and lease is carried at the lower of cost or market and represents assets acquired to assist in CAC’s mission of encouraging economic development and business retention within the City.

Property and Equipment, Net

Property and equipment is stated at cost. Depreciation of property and equipment is provided using straight-line method over the estimated useful lives of the respective assets ranging from 5 years for equipment to 40 years for buildings.

NOTE 1 — ORGANIZATION AND MISSION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Other Assets

In December 2011, Citywide Property Holdings, LLC executed a purchase option agreement for a development site on Central Avenue. Under the terms of the agreement, Citywide paid $500,000 at the time of the execution that will be applied to the purchase price of the property. Citywide can exercise the option at any time within five years from the date of the option. This amount is included in other assets in the consolidated statement of net position at December 31, 2012.

The building located at 174 North Pearl Street is vacant and as of December 31, 2012 a plan of reuse has not been developed. Accordingly, the building has been reclassified and included in other assets in the consolidated statement of net position and CAC has discontinued recording depreciation on this asset.

Description of Leasing Arrangements

CAC, as part of its mission, has entered into arrangements leasing various parcels of real estate. These arrangements include both operating and direct financing leases. The lease terms range from one to thirty years.

Use of Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Income Taxes

CAC is a publicly supported organization exempt from income taxes under Section 501(c) (3) of the Internal Revenue Code. Citywide's annual tax information filings are included with the annual filings of its sole member, CAC.

Net Position

In order to present consolidated financial condition and consolidated operating results of CAC in a manner consistent with limitations and restrictions placed upon the use of resources, CAC classifies net Position into three categories as follows:

> Net invested in capital assets – This component of net position consists of property and equipment, including property held for investment and lease, net of accumulated depreciation, and reduced by the outstanding balances of debt attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of net invested in capital assets. Rather, when applicable, that portion of the debt is included in the same net position component as the unspent proceeds.
>
> Restricted – This component of net position consists of constraints placed on assets use through external constraints imposed by creditors, by law or regulation, or through enabling legislation.
>
> Unrestricted – This component of net position consists of net position that does not meet the definition of "net invested in capital assets" or "restricted."

NOTE 1 — ORGANIZATION AND MISSION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Subsequent Events

For purposes of preparing these financial statements, CAC considered events through March 25, 2013, the date the financial statements were available for issuance.

NOTE 2 — CASH AND CASH EQUIVALENTS

CAC maintains its cash in bank accounts with several financial institutions.

CAC has not experienced any losses with respect to its cash and cash equivalents balances. Based on management's review of the strength of the financial institutions, management feels the risk of loss on its cash balances is minimal.

At December 31, 2012, the carrying amount and the bank balance of CAC's deposits were approximately $2,842,000 and $2,993,000, respectively. Of the bank balance, approximately $941,000 was insured under the FDIC coverage. Uncollateralized amounts approximated $2,052,000 at December 31, 2012, and were maintained with major financial institutions considered by management to be secure.

NOTE 3 — RESTRICTED CASH

Generally, restricted cash represents funds that have been placed in a segregated account that cannot be used for a purpose other than the purpose for which that account is designated. Restricted cash includes amounts restricted for the following purposes:

	2012
CDBG eligible activities	$ 91,676
EC/EDZ revolving loan fund	65,486
Debt service reserve	171,401
Hudson River Way campaign	59,156
Total restricted cash and cash equivalents	$ 387,719

At December 31, 2012, the bank balance of restricted cash was approximately $388,000, which was insured under FDIC coverage.

NOTE 4 — INVESTMENTS

Investments consist of the following at December 31:

	2012	
	Cost	Fair Value
Corporate Debt Securities	$ 763,306	$ 787,050
Certificates of Deposit	1,507,482	1,498,521
Equities	259,227	309,108
Other	150,485	150,485
Total	$ 2,680,500	$ 2,745,164

Unrealized gains of approximately $32,000 at December 31, 2012 are included in other interest and investment income in the consolidated statements of revenue and expenses and changes in net position.

NOTE 5 — MORTGAGE NOTES RECEIVABLE, NET

CAC's mortgage notes receivable are comprised of 45 individual accounts at December 31, 2012, with an average outstanding principal balance approximating $112,000.

Repayment terms and interest rates on mortgage loans vary with each loan. Generally, interest rates range from 0% to 9% per year, with the average yield on all loans approximating 5% for the year ended December 31, 2012. Maturities range from the short-term through the year 2080.

Substantially all mortgage notes are collateralized by a subordinate interest in real property and/or equipment.

The composition of mortgage notes receivable by funding source is as follows at December 31:

	2012	
	Number of Notes	Amount
CDBG	2	$ 52,712
UDAG	15	962,805
Other	28	4,036,844
	45	5,052,361
Less allowance for losses		(2,303,660)
Mortgage notes receivable, net		2,748,701
Less: Current portion		186,954
Noncurrent		$ 2,561,747

Of the total mortgage receivable balance approximately $597,000 as of December 31, 2012 is due from the Albany Community Development Agency (ACDA), another component unit of the City of Albany.

The recorded investment in mortgage notes receivable that are considered to be impaired approximated $2,395,000 at December 31, 2012. The allowance for losses related to impaired loans approximated $2,304,000 at December 31, 2012, respectively. Interest income recognized on impaired mortgage notes receivable, while such mortgage notes receivable were impaired, was approximately $6,000 for 2012.

NOTE 6 — RECEIVABLES FROM THE CITY OF ALBANY AND CITY AGENCIES

Included in receivables from the City of Albany and City agencies is $100,000 advanced by CAC to the Albany Community Development Agency, another component unit of the City, under a collateral loan agreement for the purpose of establishing a fund for collateral as required by the Federal National Mortgage Association for ACDA's participation in the Down Payment Assistance Program. The funds were deposited by ACDA in a restricted collateral fund held by a trustee. The funds are available to offset principal losses on mortgages granted under the Down Payment Assistance Program and to cover any shortfall in a related bond payment account to pay interest on bonds issued related to the Down Payment Assistance Program. The loan receivable matures at the earlier of the end of the Down Payment Assistance Program or August of 2013. The balance of the funds remaining is due at maturity. At December 31, 2012, the balance was $100,000.

NOTE 7 — PROPERTY HELD FOR INVESTMENT AND LEASE, NET

The following is a summary of changes in property held for investment and lease for the year ended December 31, 2012:

	January 1, 2012	Additions	Dispositions	Reclassification (see Note 1)	Impairment	December 31, 2012
Riverfront Bar & Grill - Utilities Project	$ 43,800	$ -	$ -	$ -	$ -	$ 43,800
Quackenbush Square Parking Lot	146,863	-	-	-	-	146,863
677 Broadway	449,001	-	-	-	-	449,001
174 North Pearl Street	188,391	-	-	(188,391)	-	-
Quackenbush House	199,192	-	-	-	-	199,192
Palace Properties	25,000	-	-	-	-	25,000
Corning Preserve Project	4,114,091	-	-	-	-	4,114,091
Land at 11 Clinton Avenue	225,000	-	-	-	-	225,000
	5,391,338	-	-	(188,391)	-	5,202,947
Less accumulated depreciation	1,727,987	176,780	-	(73,476)	-	1,831,291
	$ 3,663,351					$ 3,371,656

NOTE 8 — PROPERTY AND EQUIPMENT, NET

The following is a summary of changes in property and equipment for the year ended December 31, 2012:

	January 1, 2012	Additions	Dispositions	December 31, 2012
Land	$ 49,300	$ -	$ -	$ 49,300
Building and improvements	459,082	1,724	-	460,806
Furniture and equipment	116,802	15,226	-	132,028
Total	625,184	16,950	-	642,134
Less accumulated depreciation	152,830	31,485	-	184,315
	$472,354	$ (14,535)	$ -	$ 457,819

Depreciation expense, including depreciation expense on property held for investment and lease, was approximately $208,000 for the year ended December 31, 2012.

NOTE 9 — OPERATING LEASES

CAC leases the Quackenbush Square Parking Lot, Riverfront Bar & Grill, 677 Broadway (ground lease), the Quackenbush House, and Corning Preserve Project, all classified as property held for investment and lease (see Note 7), to help accomplish its economic development goals.

The following is a schedule by year of the minimum future rentals to be received on non-cancellable operating leases as of December 31, 2012:

2013	$ 302,771
2014	272,360
2015	277,919
2016	262,927
2017	258,967
Thereafter	2,903,636
	$ 4,278,580

CAC leases the Corning Preserve Project to the Albany Port District Commission (the “Port”), another component unit of the City, under a shared use and lease agreement (see Note 15). The shared use and sublease agreement has a thirty year term. Under the shared use and lease agreement the Port is obligated to make lease payments sufficient to cover all related bond debt service and certain other expenses. The annual rent payments due from the Port will change on a year to year basis as a result of the variable interest rate associated with the bonds, the amortization schedule of the bonds and bond prepayments. CAC is recognizing the base rental income on a straight-line basis ($149,000 per year) over the life of the lease based on the lease factors at inception of the lease. For the year ended December 31, 2012, rental income approximated $149,000. Increases or decreases to the base rental income result from changes in lease factors occurring subsequent to the inception of the lease and are recognized as contingent rentals in the period that the changes take place.

NOTE 10 — NET INVESTMENT IN DIRECT FINANCING LEASES

The following lists the components of the net investment in direct financing leases as of December 31:

	2012
Total minimum lease payments to be received	$ 2,865,928
Less: amounts representing executory costs (such as insurance) included in total minimum lease payments	(65,234)
Net minimum lease payments receivable	2,800,694
Less: unearned income	(709,476)
Net investment in direct financing leases	2,091,218
Less: current portion	193,589
Noncurrent	$ 1,897,629

NOTE 10 — NET INVESTMENT IN DIRECT FINANCING LEASES (Continued)

Minimum future lease payments to be received, as of December 31, 2012, for the remaining lease terms, are as follows:

2013	$ 342,685
2014	343,952
2015	340,211
2016	333,464
2017	329,718
Thereafter	1,175,898
Total minimum lease payments to be received	$2,865,928

Net investment in direct financing leases is comprised primarily of the following leases with related parties:

A lease with ACDA, related to a facility located at 200 Henry Johnson Boulevard. In addition, a master lease agreement with the City guarantees the required lease payments of ACDA. The lease with ACDA required an up-front payment of $300,000 and variable semi-annual payments over the remaining lease term (payments approximate $190,000 annually). Portions of the payments are utilized by CAC to fund their debt service obligation for the related bonds payable (see Note 12). The lease has a twenty-five year term and matures in March 2018. The net investment in the lease approximated $845,000 as of December 31, 2012. Income earned during 2012 approximated $94,000.

A lease with the Port, related to a warehouse facility. In 2004, the lease with the Port was amended to reflect CAC's refinancing related bonds payable (see Note 12). The lease amendment with the Port requires monthly payments of $8,718 which is equivalent to CAC's debt service obligation for related bonds payable (see Note 12). The lease has a twenty year term and matures in November 2024. The net investment in the lease approximated $993,000 as of December 31, 2012. Income earned during 2012 approximated $43,000.

A lease with the City, related to the Albany Police Department's North Station, requiring annual payments of $22,088. The lease has a twenty year term and matures in July 2018. The net investment in the lease approximated $87,000 as of December 31, 2012. Income earned during 2012 approximated $6,000.

NOTE 11 — DUE TO THE CITY OF ALBANY

Due to the City of Albany consists of the following at December 31:

	2012
Professional services fee payable	$ 40,000
Hudson River Way project	59,448
	$ 99,448

During 2012, CAC entered into a professional services agreement with the City of Albany. Under this agreement the City of Albany provides economic development, planning, and community development consultancy services in furtherance of CAC's mission. The fee under the agreement is determined annually. In 2012, CAC's fee to the City of Albany under this agreement totaled $160,000. The agreement carries a one-year term with automatic consecutive one-year renewals unless terminated by either party.

NOTE 12 — BONDS PAYABLE

The following is a summary of changes in bonds payable for the year ended December 31, 2012:

	January 1, 2012	Increases	Decreases	December 31, 2012
Bonds Payable:				
AIDA Port Warehouse Project (A)	$ 1,055,548	$ -	$ (62,112)	$ 993,436
AIDA Henry Johnson Boulevard Project (B)	955,000	-	(115,000)	840,000
AIDA Corning Preserve Project (C)	2,520,000	-	(145,000)	2,375,000
	4,530,548	-	(322,112)	4,208,436
Less current maturities	322,112			339,846
	$ 4,208,436			$ 3,868,590

(A) CAC functioned as the conduit agency in connection with a 1994 bond issue of the Albany Industrial Development Agency (AIDA), another component unit of the City, in the amount of $1,675,000. The net proceeds were utilized to fund a project to construct a building for the Port. The transaction has been recorded at the amount of debt assumed under the bond issue. The building is leased to the Port under a related lease agreement that has been classified as a direct financing lease (see Note 10). In 2004, the 1994 bond was refinanced through the issuance of a 2004A bond of the AIDA in the amount of $1,430,000. The 2004A bond requires monthly payments of principal and interest in the amount of $8,718, with interest at a rate of 4.07% per annum. The bond matures in November 2014. Accordingly, the lease with the Port was amended in 2004 (see Note 10).

(B) CAC functioned as the conduit agency in connection with a 1994 bond issue of the AIDA in the amount of $1,975,000. The net proceeds were utilized to fund a project to construct a building for the City and City Agencies. The transaction has been recorded at the amount of debt assumed under the bond issue. The bonds require semi-annual payment of interest and the interest rate is adjusted every five years. Principal payments are required annually on March 1 in prescribed amounts currently ranging from $100,000 to $160,000. The obligation matures in March 2018. The interest rate at December 31, 2012 was 5.75%. The building is leased to ACDA under a related lease agreement that has been classified as a direct financing lease (see Note 10).

(C) CAC functioned as the conduit agency in connection with a 2002 Civic Facility Revenue bond issue of the AIDA in the amount of $4,390,000. The proceeds were utilized to fund a project that includes the construction of various improvements to the Corning Preserve Park. The obligation requires monthly payment of interest and the interest rate is adjusted weekly. The bonds are secured by a letter of credit issued by Key Bank. The letter of credit requires principal payments on the outstanding bonds, annually on May 1, in prescribed amounts currently ranging from $140,000 to $255,000. The letter of credit also requires principal payments on the outstanding bonds if certain grant proceeds related to the Corning Preserve Project are received. The bonds mature in May 2027. The interest rate at December 31, 2012 was 0.25%. The Corning Preserve Project is leased to the Port under a related agreement that has been classified as an operating lease (see Note 9).

NOTE 12 — BONDS PAYABLE (Continued)

At December 31, 2012, principal and interest requirements to maturity are as follows:

	Principal	Interest
2013	$ 339,846	$ 90,236
2014	1,218,590	79,934
2015	300,000	34,867
2016	320,000	26,398
2017	330,000	17,480
2018 - 2022	1,205,000	17,103
2023 - 2027	495,000	1,133
	$ 4,208,436	$ 267,151

NOTE 13 — REVOLVING LOAN FUND LIABILITY

In June 1999, CAC was awarded a grant of $643,291 to establish and operate a revolving loan fund to benefit prospective or existing Enterprise Community and/or Economic Development Zone (EC/EDZ) businesses. Generally, repayments on loans originated are to be recycled back into the loan fund to provide additional loans. However, with approval from the Empire State Development Corporation ("ESDC"), interest generated from the loans can be recorded as revenue to the extent that it offsets administrative expenses related to operating the loan fund. Approximately $34,000 of such revenue was recognized for the year ended December 31, 2012.

NOTE 14 — RETIREMENT PLAN

Simplified Employee Pension Plan (SEP-IRA)

Plan Description: Simplified Employee Pension Plan is an employer-funded retirement plan with 100% immediate vesting. Maximum employee limit is 25% of gross compensation not to exceed $49,000. Distributions taken prior to age 59 ½ may be subject to 10% premature penalty tax in addition to ordinary income tax. The Plan must be adopted and funded by employer's tax filing deadline, plus extensions, for prior year deductibility.

Funding Requirements: CAC has elected to contribute 11% of an eligible employee's compensation annually to the SEP-IRA. At December 31, 2012, five employees were covered by the SEP-IRA, and total contributions were approximately $35,000.

Post Employment Benefit

CAC does not offer post employment benefit to its employees.

NOTE 15 — CORNING PRESERVE PROJECT

CAC, in 2002, functioned as the conduit agency with several related parties related to a project to construct various improvements to a portion of the Corning Preserve Park (Corning Preserve Project). CAC entered into an interim use and ground lease agreement with the City providing for a ground lease of the property owned by the City, underlying the Corning Preserve Project. The interim use and ground lease agreement has a thirty-five year term and provides for a nominal rent payment. At the end of the lease term the Corning Preserve Project reverts to the City.

CAC entered into a lease agreement with the AIDA to sublease the property to the AIDA. The sublease expires at the earlier of a date requested by CAC or the completion date of the Corning Preserve Project. The lease agreement provides for a nominal payment. CAC also entered into an installment sale agreement with the AIDA pursuant to which CAC is obligated, among other things, to complete the Corning Preserve Project as the agent of the AIDA and the AIDA sells the Corning Preserve Project to CAC on an installment basis. CAC's payments under the installment sale agreement are equivalent to the debt service requirements on the $4,390,000 in 2002 Civic Facility Revenue Bonds issued by the AIDA to fund the Corning Preserve Project, which is accounted for as bonds payable (see Note 12).

CAC entered into a shared use and sublease agreement with the Port. Under the shared use and sublease agreement the Port is obligated to perform on behalf of CAC, CAC's obligations under the interim use and ground lease agreement and the installment sale agreement. Also under the shared use and sublease agreement, which is accounted for as an operating lease, the Port is obligated to fund CAC's obligations relating to the Corning Preserve Project, including funding payments sufficient to cover all related bond debt service and certain other expenses (see Note 9).

NOTE 16 — COMMITMENTS AND CONTINGENCIES

Regulatory Review

In the normal course of business, the Corporation is subject to certain regulatory review including operational review. Although the outcome of certain regulatory review is not determined, the management does not believe that the review could have a material adverse effect on its financial position, results of operations or cash flows.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Capitalize Albany Corporation

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the consolidated financial statements of Capitalize Albany Corporation (a component reporting unit of the City of Albany), which comprise the consolidated statement of net position as of December 31, 2012, and the related consolidated statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated March 25, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered Capitalize Albany Corporation's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of Capitalize Albany Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of Capitalize Albany Corporation's internal control.

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Capitalize Albany Corporation's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

UHY LLP

Albany, New York
March 25, 2013