

CAPITAL PROPERTIES INC /RI/

Form 10-Q

November 08, 2016

[Table of Contents](#)

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, DC 20549**

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the quarterly period ended September 30, 2016**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 001-08499**

**CAPITAL PROPERTIES, INC.**

**(Exact name of registrant as specified in its charter)**

**Rhode Island**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**05-0386287**  
**(IRS Employer**  
**Identification No.)**

**100 Dexter Road**  
**East Providence, Rhode Island**  
**(Address of principal executive offices)**

**02914**  
**(Zip Code)**

**(401) 435-7171**

**(Registrant's telephone number, including area code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of September 30, 2016, the Company had 6,599,912 shares of Class A Common Stock outstanding.

Table of Contents

**CAPITAL PROPERTIES, INC.**  
**FORM 10-Q**  
**FOR THE QUARTER ENDED SEPTEMBER 30, 2016**  
**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I FINANCIAL INFORMATION</u></b>	
Item 1.	<u>Financial Statements</u> 3
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 13
Item 4.	<u>Controls and Procedures</u> 17
<b><u>PART II OTHER INFORMATION</u></b>	
Item 6.	<u>Exhibits</u> 18
	<u>Signatures</u> 19
Exhibits 31	<u>Certifications Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
Exhibits 32	<u>Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>

Table of ContentsPART I**Item 1. Financial Statements****CAPITAL PROPERTIES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

	September 30, 2016 (unaudited)	December 31, 2015
<b>ASSETS</b>		
Properties and equipment (net of accumulated depreciation)	\$ 19,343,000	\$ 19,833,000
Cash	2,971,000	2,225,000
Income taxes receivable	92,000	
Prepaid and other	517,000	623,000
	\$ 22,923,000	\$ 22,681,000
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Liabilities:		
Dividend notes payable	\$ 10,608,000	\$ 11,787,000
Accounts payable and accrued expenses:		
Property taxes	295,000	282,000
Environmental remediation	77,000	79,000
Other	453,000	501,000
Income taxes payable		66,000
Deferred income taxes, net	4,597,000	4,720,000
	16,030,000	17,435,000
Shareholders' equity:		
Class A common stock, \$.01 par; authorized 10,000,000 shares; issued and outstanding 6,599,912 shares	66,000	66,000
Capital in excess of par	782,000	782,000
Retained earnings	6,045,000	4,398,000
	6,893,000	5,246,000
	\$ 22,923,000	\$ 22,681,000

See notes to consolidated financial statements.



**Table of Contents**

## CAPITAL PROPERTIES, INC. AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF INCOME****THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015****(Unaudited)**

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
<b>Revenues:</b>				
Leasing	\$ 1,242,000	\$ 1,249,000	\$ 3,860,000	\$ 3,763,000
Petroleum storage facility	892,000	883,000	2,664,000	2,638,000
	2,134,000	2,132,000	6,524,000	6,401,000
<b>Expenses:</b>				
Leasing	193,000	207,000	622,000	653,000
Petroleum storage facility	648,000	561,000	1,814,000	1,865,000
General and administrative	294,000	255,000	941,000	828,000
<b>Interest on notes:</b>				
Bank loan		14,000		62,000
Dividend notes	132,000	147,000	445,000	442,000
	1,267,000	1,184,000	3,822,000	3,850,000
<b>Income before income taxes</b>	<b>867,000</b>	<b>948,000</b>	<b>2,702,000</b>	<b>2,551,000</b>
<b>Income tax expense (benefit):</b>				
Current	343,000	345,000	1,178,000	1,145,000
Deferred	(5,000)	27,000	(123,000)	(144,000)
	338,000	372,000	1,055,000	1,001,000
<b>Net income</b>	<b>\$ 529,000</b>	<b>\$ 576,000</b>	<b>\$ 1,647,000</b>	<b>\$ 1,550,000</b>
<b>Basic income per common share based upon 6,599,912 shares outstanding</b>	<b>\$ .08</b>	<b>\$ .08</b>	<b>\$ .25</b>	<b>\$ .23</b>

See notes to consolidated financial statements.

**Table of Contents****CAPITAL PROPERTIES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015****(Unaudited)**

	2016	2015
<b>Cash flows from operating activities:</b>		
Net income	\$ 1,647,000	\$ 1,550,000
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation	507,000	606,000
Amortization of deferred costs	28,000	33,000
Deferred income taxes	(123,000)	(144,000)
Other, principally net changes in prepaids, accounts payable, accrued expenses and current income taxes	(117,000)	(131,000)
Net cash provided by operating activities	1,942,000	1,914,000
<b>Cash flows from investing activities:</b>		
Purchases of properties and equipment	(17,000)	(349,000)
<b>Cash flows from financing activities:</b>		
Partial redemption of dividend notes payable	(1,179,000)	
Principal payments on note payable, bank		(2,214,000)
Cash used in financing activities	(1,179,000)	(2,214,000)
Increase (decrease) in cash	746,000	(649,000)
Cash, beginning	2,225,000	2,927,000
Cash, ending	\$ 2,971,000	\$ 2,278,000
<b>Supplemental disclosures:</b>		
<b>Cash paid for:</b>		
Income taxes	\$ 1,336,000	\$ 1,158,000
Interest	\$ 295,000	\$ 350,000

See notes to consolidated financial statements.

**Table of Contents**

**CAPITAL PROPERTIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015**

**(Unaudited)**

**1. Description of business:**

Capital Properties, Inc. and its wholly-owned subsidiaries, Tri-State Displays, Inc., Capital Terminal Company and Dunellen, LLC (collectively referred to as the Company ), operate in two segments, leasing and petroleum storage.

The leasing segment consists of the long-term leasing of certain of its real estate interests in downtown Providence, Rhode Island (upon the commencement of which the tenants are required to construct buildings thereon, with the exception of a parking garage and Parcels 6B and 6C), the leasing of a portion of its building ( Steeple Street Building ) under short-term leasing arrangements and the leasing of locations along interstate and primary highways in Rhode Island and Massachusetts to Lamar Outdoor Advertising, LLC ( Lamar ) which has constructed outdoor advertising boards thereon. The Company anticipates that the future development of its remaining properties in and adjacent to the Capital Center area will consist primarily of long-term ground leases. Pending this development, the Company leases these parcels for public parking under short-term leasing arrangements to Metropark, Ltd. ( Metropark ).

The petroleum storage segment consists of operating the petroleum storage terminal (the Terminal ) containing 1,004,000 shell barrels and the Wilkesbarre Pier (the Pier ), both of which are owned by the Company and are collectively referred to as the Facility, located in East Providence, Rhode Island for Sprague Operating Resources LLC ( Sprague ), a wholly-owned subsidiary of Sprague Resources LP, which stores and distributes petroleum products.

The principal difference between the two segments relates to the nature of the operations. In the leasing segment, the tenants under long-term land leases incur substantially all of the development and operating costs of the assets constructed on the Company s land, including the payment of real property taxes on both the land and any improvements constructed thereon. In the petroleum storage segment, the Company is responsible for the operating and maintenance expenditures and real estate taxes up to \$290,000, as well as capital improvements at the Facility.

**2. Principles of consolidation and basis of presentation:**

The accompanying condensed consolidated financial statements include the accounts and transactions of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying condensed consolidated balance sheet as of December 31, 2015, has been derived from audited financial statements and the unaudited interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with United States generally accepted accounting principles ( GAAP ) have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated



financial statements and the notes thereto included in the Company's latest Form 10-K. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments (consisting solely of normal recurring adjustments) necessary to present fairly the financial position as of September 30, 2016, the results of operations for the three and nine months ended September 30, 2016 and 2015, and the cash flows for the nine months ended September 30, 2016 and 2015.

The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

*Environmental incidents:*

The Company accrues a liability when an environmental incident has occurred and the costs are estimable. The Company does not record a receivable for recoveries from third parties for environmental matters until it has determined that the amount of the collection is reasonably assured. The accrued liability is relieved when the Company pays the liability or a third party assumes the liability. Upon determination that collection is reasonably assured or a third party assumes the liability, the Company records the amount as a reduction of expense.

**Table of Contents**

The Company charges to expense those costs that do not extend the life, increase the capacity or improve the safety or efficiency of the property owned or used by the Company.

*New accounting standards:*

The Company reviews new accounting standards as issued. Although some of these accounting standards may be applicable to the Company, the Company expects that none of the new standards will have a significant impact on its consolidated financial statements.

**3. Use of estimates:**

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

**4. Properties and equipment:**

Properties and equipment consists of the following:

	September 30, 2016	December 31, 2015
<b>Properties on lease or held for lease:</b>		
Land and land improvements	\$ 4,701,000	\$ 4,701,000
Building and improvements, Steeple Street	5,820,000	5,808,000
	10,521,000	10,509,000
<b>Petroleum storage facility, on lease:</b>		
Land and land improvements	6,081,000	6,076,000
Buildings and structures	1,867,000	1,867,000
Tanks and equipment	14,770,000	14,770,000
	22,718,000	22,713,000
Office equipment	112,000	112,000
	33,351,000	33,334,000
<b>Less accumulated depreciation:</b>		
Properties on lease or held for lease	1,365,000	1,214,000
Petroleum storage facility, on lease	12,550,000	12,199,000
Office equipment	93,000	88,000

14,008,000 13,501,000

\$ 19,343,000	\$ 19,833,000
---------------	---------------

**5. Notes payable:***Dividend notes:*

In 2012, the Company issued \$11,787,000 in principal face amount of 5% dividend notes due December 26, 2022 (the Dividend Notes). The Dividend Notes are unsecured general obligations of the Company bearing interest at the annual rate of 5% payable semi-annually on June 15 and December 15 to note holders of record on June 1 and December 1 of each year. The Dividend Notes may be redeemed in whole or in part at any time and from time to time at the option of the Company. The Dividend Notes are subject to mandatory redemption in an amount equal to the Net Proceeds from the sale of any real property owned by the Company or any of its subsidiaries. Net Proceeds is defined as the gross cash received by the Company from any such sale reduced by the sum of (a) costs relating to the sale, (b) federal and state income taxes as a result of the sale, and (c) the amount used by the Company to pay in whole or in part financial institution debts secured by a mortgage of the Company's or any subsidiary's real property regardless of whether such mortgage encumbers the property sold. The Company has obligated itself not to grant any mortgages on any of its property located in the Capital Center District in Providence, Rhode Island, and to cause its subsidiaries not to grant any such mortgages, in each case without the consent of the holders of two-thirds of the outstanding principal face amount of the Dividend Notes. The Dividend Notes contain other customary terms and conditions.

On June 15, 2016, the Company redeemed 10 percent of the face value of its outstanding Dividend Notes (\$1,179,000) to note holders of record on June 2, 2016. At September 30, 2016, the remaining balance is \$10,608,000.

**Table of Contents**

**6. Description of leasing arrangements:**

*Long-term land leases:*

As of September 30, 2016, the Company had entered into nine long-term land leases. Of the nine parcels, seven have had improvements constructed thereon.

Under the nine land leases, the tenants are required to negotiate any tax stabilization treaties or other arrangements, appeal any changes in real property assessments, and pay real property taxes assessed on land and improvements under these arrangements. Accordingly, real property taxes payable by the tenants are excluded from leasing revenues and leasing expenses on the accompanying consolidated statements of income. Real property taxes attributable to the Company's land under these leases totaled \$305,000 and \$910,000, respectively, for the three and nine months ended September 30, 2016, and \$308,000 and \$923,000, respectively, for the three and nine months ended September 30, 2015.

With respect to the Parcel 6B and 6C leases, each lessee has the right to terminate its lease at any time during the remaining term of that lease upon thirty days' notice. To date, no notice of termination has been received by the Company. The current annual rent on Parcel 6B and 6C are \$195,000 and \$200,000, respectively.

*Lamar lease:*

The Company, through a wholly-owned subsidiary, leases 23 outdoor advertising locations containing 44 billboard faces along interstate and primary highways in Rhode Island and Massachusetts to Lamar under a lease which expires in 2045. The Lamar lease provides, among other things, for the following: (1) the base rent will increase annually at the rate of 2.75% for each leased billboard location on June 1 of each year, and (2) in addition to base rent, for each 12-month period commencing each June 1, Lamar must pay to the Company within thirty days after the close of the lease year 30% of the gross revenues from each standard billboard and 20% of the gross revenues from each electronic billboard for such 12-month period, reduced by the sum of (a) commissions paid to third parties and (b) base monthly rent for each leased billboard display for each 12-month period. For the lease years ended May 31, 2016 and 2015, the percentage rent totaled \$118,000 and \$155,000, respectively, which amounts are included in leasing revenues on the accompanying consolidated statements of income for the nine months ended September 30, 2016 and 2015.

*Short-term leases:*

The Company leases the undeveloped parcels of land in or adjacent to the Capital Center area for public parking purposes to Metropark under a short-term cancellable lease.

At September 30, 2016, the Company has three tenants occupying 54 percent of the Steeple Street Building under short-term leases of five years or less at a current annual rental of \$125,000. The Company is recognizing the revenue from these leases on a straight-line basis over the terms of the leases. At September 30, 2016, there was no excess of straight-line over contractual rentals; at December 31, 2015, the excess of straight-line over contractual rentals was \$1,000, which is included in prepaid and other on the accompanying consolidated balance sheet. The Company also reports as revenue from tenants reimbursements for common area costs and real property taxes. The Company is currently marketing the remaining portions of the building for lease.

**7. Petroleum storage facility and environmental incidents:**

*Leasing of the Facility:*

On May 1, 2014, the Company entered into a Petroleum Storage Services Agreement ( the Agreement ) with Sprague Operating Resources, LLC ( Sprague ) for the lease of its entire storage capacity of 1,004,000 barrels for a term of five years. The base rent is \$3,500,000, subject to annual cost-of-living adjustments on May 1 of each year. On May 1, 2016, the annual rent increased \$39,000. There was no change in the base rent on May 1, 2015 because the cost-of-living decreased from May 1, 2014. In addition, the Company will receive an additional \$.15 for each barrel of throughput at the facility in excess of 3,500,000 barrels in any contract year (May 1 to April 30). The total throughput for the years ended April 30, 2016 and 2015 did not exceed 3,500,000 barrels. Sprague had the right to extend the Agreement for two additional terms of five years each, provided that Sprague gives at least twelve months notice prior to the expiration of the initial or the extension term, as applicable. Commencing April 1, 2016 and on each April 1 thereafter during the initial term and any extension term, either party during the following thirty days had the right to terminate the Agreement as of April 30 of the year next following the year in which notice of termination is given. On April 28, 2016, the Company received notice from Sprague that, effective April 30, 2017, Sprague is terminating the Agreement. The Company is reviewing its options for the petroleum storage facility upon termination of the Sprague lease.

## Table of Contents

Commencing May 1, 2015, Sprague is obligated to reimburse the Company for any real property taxes in excess of \$290,000. For the year 2016, there was an increase in the assessment but a decrease in the tax rate, resulting in no additional payment being due from Sprague. For the year 2015, there was no increase in the assessment or tax rate and therefore no additional payment was due from Sprague.

The Company incurred \$108,000 in fees in connection with the execution of the Agreement, which amounts are being amortized on the straight-line method over the three-year non-cancellable portion of the term of the Agreement and are included in petroleum storage facility expenses on the accompanying consolidated statements of income for the three and nine months ended September 30, 2016 and 2015. At September 30, 2016 and December 31, 2015, unamortized deferred agreement costs were \$20,000 and \$48,000, respectively, which are included in prepaid and other on the accompanying consolidated balance sheets.

### *Wilkesbarre Pier:*

The Pier is a deep-water pier in East Providence, Rhode Island owned by the Company which is integral to the operation of the Terminal. The Pier and the Terminal are connected by two petroleum pipelines which the Company has a permanent right to use.

### *Environmental incident (2002):*

In 2002, during testing of monitoring wells at the Terminal, the Company's consulting engineer discovered free floating phase product in a groundwater monitoring well located on that portion of the Terminal purchased in 2000. Laboratory analysis indicated that the product was gasoline, which is not a product the Company ever stored at the Terminal. The Company commenced an environmental investigation and analysis, the results of which indicate that the gasoline did not come from the Terminal. The Company notified the Rhode Island Department of Environmental Management (RIDEM). RIDEM subsequently identified Power Test Realty Partnership (Power Test), the owner of an adjacent parcel, as a potentially responsible party for the contamination. Getty Properties Corp. is the general partner of Power Test. Power Test challenged that determination and, after an administrative hearing, in October 2008 a RIDEM Hearing Officer determined that Power Test is responsible for the discharge of the petroleum product under the Rhode Island Oil Pollution Control Act, R.I.G.L. Section 46-12.5.1-3 and Rule 6(a) and 12(b) of the Oil Pollution Control Regulations. The RIDEM Decision and Order requires Power Test to remediate the contamination as directed by RIDEM. In November 2008, Power Test appealed the decision. In March 2016, the Rhode Island Supreme Court affirmed the RIDEM decision.

In April 2009, the Company sued Power Test and Getty Properties Corp. in the Rhode Island Superior Court seeking remediation of the site or, in the alternative, the cost of the remediation. On May 1, 2009, Power Test and Getty Properties Corp. removed the action to the United States District Court for the District of Rhode Island (the Court). On May 22, 2009, Power Test and Getty Properties Corp. answered the Complaint and filed a Counterclaim against Dunellen, LLC and Capital Terminal Company alleging that Dunellen, LLC and Capital Terminal Company are responsible for the contamination. Getty Properties Corp. and Power Test joined Getty Petroleum Marketing, Inc., the tenant under a long-term lease with Getty Properties Corp. of the adjacent property, as a defendant. The Company amended its Complaint to add Getty Petroleum Marketing, Inc. as a defendant. Getty Petroleum Marketing, Inc. moved for summary judgment against the Company, Getty Properties Corp. and Power Test. On December 5, 2011, Getty Petroleum Marketing, Inc. filed for bankruptcy under Chapter 11 of the United States Bankruptcy Act. Thereafter, with Bankruptcy Court approval, Getty Petroleum Marketing, Inc. rejected its lease with Getty Properties Corp. On August 24, 2012, the Bankruptcy Court approved a plan to liquidate Getty Petroleum Marketing, Inc. On January 15, 2013, the Court granted Getty Petroleum Marketing, Inc.'s motion for summary judgment against the Company, Getty Properties Corp. and Power Test, dismissing the Company's third-party complaint.

The parties agreed to stay the litigation pending a determination by the Rhode Island Supreme Court on the Power Test appeal. On September 12, 2016, the parties entered into a Tolling Agreement under which the statute of limitations is tolled to not later than sixty days following implementation by Power Test of the RIDEM approved remediation plan. On September 19, 2016, the parties dismissed the litigation without prejudice.

Since January 2003, the Company has not incurred significant costs in connection with this matter, other than ongoing litigation costs, and is unable to determine the costs it might incur to remedy the situation, as well as any costs to investigate, defend and seek reimbursement from the responsible party with respect to this contamination.

*Environmental remediation (1994):*

In 1994, a leak was discovered in a 25,000 barrel storage tank at the Terminal which allowed the escape of a small amount of fuel oil. All required notices were made to RIDEM. In 2000, the tank was demolished and testing of the groundwater indicated that there was no large pooling of contaminants. In 2001, RIDEM approved a plan pursuant to which the Company installed a passive system consisting of three wells and commenced monitoring the wells.

**Table of Contents**

In 2003, RIDEM decided that the passive monitoring system previously approved was not sufficient and required the Company to design an active remediation system for the removal of product from the contaminated site. The Company and its consulting engineers began the pre-design testing of the site in the fourth quarter of 2004. The consulting engineers estimated a total cost of \$200,000 to design, install and operate the system, which amount was accrued in 2004. Through 2006, the Company had expended \$119,000 and has not incurred any significant costs since then. In 2011, RIDEM notified the company to proceed with the next phase of the approval process, notifying the abutters of the proposed remediation system even though RIDEM has not yet taken any action on the Company's proposed plan. As designed, the system will pump out the contaminants which will be disposed of in compliance with applicable regulations. After a period of time, the groundwater will be tested to determine if sufficient contaminants have been removed. In 2014, the Company engaged new consultants to work with RIDEM to develop the next phase of the approval process. While the Company and its consulting engineers believe that the proposed active remediation system will correct the situation, it is possible that RIDEM could require the Company to expand remediation efforts, which could result in the Company incurring costs in excess of the remaining accrual of \$77,000.

**8. Income taxes:**

Deferred income taxes are recorded based upon differences between financial statement and tax basis amounts of assets and liabilities. The tax effects of temporary differences which give rise to deferred tax assets and liabilities were as follows:

	September 30, 2016	December 31, 2015
<b>Gross deferred tax liabilities:</b>		
Property having a financial statement basis in excess of tax basis	\$ 4,633,000	\$ 4,725,000
Insurance premiums and accrued leasing revenues	92,000	137,000
	4,725,000	4,862,000
Deferred tax assets	(128,000)	(142,000)
	\$ 4,597,000	\$ 4,720,000

**9. Operating segment disclosures:**

The Company operates in two segments, leasing and petroleum storage.

The Company makes decisions relative to the allocation of resources and evaluates performance based on each segment's respective income before income taxes, excluding interest expense and certain corporate expenses.

Inter-segment revenues are immaterial in amount.

The following financial information is used for making operating decisions and assessing performance of each of the Company's segments for the three and nine months ended September 30, 2016 and 2015:



	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
<i>Leasing:</i>				
Revenues:				
Long-term land leases:				
Contractual	\$ 1,003,000	\$ 993,000	\$ 2,996,000	\$ 2,868,000
Contingent	25,000	32,000	194,000	232,000
Short-term leases	214,000	224,000	670,000	663,000
<b>Total revenues</b>	<b>\$ 1,242,000</b>	<b>\$ 1,249,000</b>	<b>\$ 3,860,000</b>	<b>\$ 3,763,000</b>
Property tax expense	\$ 112,000	\$ 106,000	\$ 336,000	\$ 316,000
Depreciation	\$ 42,000	\$ 44,000	\$ 151,000	\$ 151,000
Income before income taxes	\$ 1,049,000	\$ 1,042,000	\$ 3,238,000	\$ 3,110,000
<b>Assets</b>	<b>\$ 9,656,000</b>	<b>\$ 9,670,000</b>	<b>\$ 9,656,000</b>	<b>\$ 9,670,000</b>
Properties and equipment, additions	\$	\$ 6,000	\$ 12,000	\$ 263,000

**Table of Contents**

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
<i>Petroleum storage:</i>				
Revenues, contractual	\$ 892,000	\$ 883,000	\$ 2,664,000	\$ 2,638,000
Property tax expense	\$ 73,000	\$ 73,000	\$ 214,000	\$ 217,000
Depreciation	\$ 116,000	\$ 124,000	\$ 351,000	\$ 450,000
Income (loss) before income taxes	\$ 244,000	\$ 322,000	\$ 850,000	\$ 773,000
Assets	\$ 11,214,000	\$ 11,071,000	\$ 11,214,000	\$ 11,071,000
Properties and equipment, additions	\$	\$ 15,000	\$ 5,000	\$ 86,000

The following is a reconciliation of the segment information to the amounts reported in the accompanying consolidated financial statements for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
Revenues for operating segments:				
Leasing	\$ 1,242,000	\$ 1,249,000	\$ 3,860,000	\$ 3,763,000
Petroleum storage	892,000	883,000	2,664,000	2,638,000
Total consolidated revenues	\$ 2,134,000	\$ 2,132,000	\$ 6,524,000	\$ 6,401,000
Property tax expense:				
Property tax expense for operating segments:				
Leasing	\$ 112,000	\$ 106,000	\$ 336,000	\$ 316,000
Petroleum storage	73,000	73,000	214,000	217,000
	185,000	179,000	550,000	533,000
Unallocated corporate property tax expense			2,000	2,000
Total consolidated property tax expense	\$ 185,000	\$ 179,000	\$ 552,000	\$ 535,000
Depreciation:				
Depreciation for operating segments:				
Leasing	\$ 42,000	\$ 44,000	\$ 151,000	\$ 151,000
Petroleum storage segment:	116,000	124,000	351,000	450,000
	158,000	168,000	502,000	601,000
Unallocated corporate depreciation	2,000	2,000	5,000	5,000

Edgar Filing: CAPITAL PROPERTIES INC /RI/ - Form 10-Q

Total consolidated depreciation	\$ 160,000	\$ 170,000	\$ 507,000	\$ 606,000
<b>Income before income taxes:</b>				
<b>Income before income taxes for operating segments:</b>				
Leasing	\$ 1,049,000	\$ 1,042,000	\$ 3,238,000	\$ 3,110,000
Petroleum storage	244,000	322,000	850,000	773,000
	1,293,000	1,364,000	4,088,000	3,883,000
Unallocated corporate expenses	(294,000)	(255,000)	(941,000)	(828,000)
Interest expense	(132,000)	(161,000)	(445,000)	(504,000)
Total consolidated income before income taxes	\$ 867,000	\$ 948,000	\$ 2,702,000	\$ 2,551,000
<b>Assets:</b>				
<b>Assets for operating segments:</b>				
Leasing	\$ 9,656,000	\$ 9,670,000	\$ 9,656,000	\$ 9,670,000
Petroleum storage	11,214,000	11,071,000	11,214,000	11,071,000
	20,870,000	20,741,000	20,870,000	20,741,000
Corporate cash	1,942,000	1,885,000	1,942,000	1,885,000
Other unallocated amounts	111,000	27,000	111,000	27,000
Total consolidated assets	\$ 22,923,000	\$ 22,653,000	\$ 22,923,000	\$ 22,653,000

**Table of Contents**

	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
Properties and equipment:				
Additions to properties and equipment for operating segments:				
Leasing	\$	\$ 6,000	\$ 12,000	\$ 263,000
Petroleum storage		15,000	5,000	86,000
<b>Total consolidated additions</b>	<b>\$</b>	<b>\$ 21,000</b>	<b>\$ 17,000</b>	<b>\$ 349,000</b>

**10. Fair value of financial instruments:**

The Company believes that the fair values of its financial instruments, including cash, receivables and payables, approximate their respective book values because of their short-term nature. Upon review of current market conditions and other factors, the Company believes that the fair value of the dividend notes payable approximates their book value. The fair values described herein were determined using significant other observable inputs (Level 2) as defined by GAAP.

**Table of Contents**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**FORWARD LOOKING STATEMENTS**

Certain portions of this report, and particularly the Management's Discussion and Analysis of Financial Condition and Results of Operations, contain forward-looking statements within the meaning of Sections 27A of the Securities Act of 1933, as amended, and Sections 21E of the Securities Exchange Act of 1934, as amended, which represent the Company's expectations or beliefs concerning future events. The Company cautions that these statements are further qualified by important factors that could cause actual results to differ materially from those in the forward-looking statements, including, without limitation, the following: the ability of the Company to generate adequate amounts of cash; the collectibility of the accrued leasing revenues when due over the terms of the long-term land leases and the early termination of the Parcel 6B and Parcel 6C land leases; the commencement of additional long-term land leases; changes in economic conditions that may affect either the current or future development on the Company's parcels; the marketing of the petroleum terminal for lease; and exposure to contamination, remediation or similar costs associated with the operation of the petroleum storage facility. The Company does not undertake the obligation to update forward-looking statements in response to new information, future events or otherwise.

**1. Overview:**

*Critical accounting policies:*

The Company believes that its revenue recognition policy for long-term leases with scheduled rent increases (leasing segment) meets the definition of a critical accounting policy which is discussed in the Company's Form 10-K for the year ended December 31, 2015. There have been no changes to the application of this accounting policy since December 31, 2015.

*Segments:*

The Company operates in two segments, leasing and petroleum storage.

The leasing segment consists of the long-term leasing of certain of its real estate interests in downtown Providence, Rhode Island (upon the commencement of which the tenants have been required to construct buildings thereon, with the exception of a parking garage and Parcels 6B and 6C), the leasing of a portion of the Steeple Street Building under short-term leasing arrangements and the leasing of locations along interstate and primary highways in Rhode Island and Massachusetts to Lamar Outdoor Advertising, LLC (Lamar) which has constructed outdoor advertising boards thereon. The Company anticipates that the future development of its remaining properties in and adjacent to the Capital Center area will consist primarily of long-term ground leases. Pending this development, the Company leases these parcels for public parking under short-term leasing arrangements to Metropark, Ltd. (Metropark).

The petroleum storage segment consists of operating the petroleum storage terminal (the Terminal) containing 1,004,000 shell barrels and the Wilkesbarre Pier (the Pier), both of which are owned by the Company and are collectively referred to as the Facility, located in East Providence, Rhode Island for Sprague Operating Resources LLC (Sprague), a wholly-owned subsidiary of Sprague Resources LP, which stores and distributes petroleum products.

The principal difference between the two segments relates to the nature of the operations. In the leasing segment, the tenants under long-term land leases incur substantially all of the development and operating costs of the assets constructed on the Company's land, including the payment of real property taxes on both the land and any improvements constructed thereon. In the petroleum storage segment, the Company is responsible for the operating and maintenance expenditures and real estate taxes up to \$290,000 as well as capital improvements at the Facility.

---

**Table of Contents****2. Liquidity and capital resources:***Dividend notes:*

On December 7, 2012, the Board of Directors of the Company declared an extraordinary dividend of \$2.25 per share on its Class A and Class B common stock to shareholders of record on December 17, 2012. On December 27, 2012, the Company paid out \$3,063,000 in cash and issued \$11,787,000 in principal face amount of 5% dividend notes due December 26, 2022 (the Dividend Notes). The Dividend Notes are unsecured general obligations of the Company bearing interest at the annual rate of 5% payable semi-annually on June 15 and December 15 to note holders of record on June 1 and December 1 of each year. The Dividend Notes may be redeemed in whole or in part at any time and from time to time at the option of the Company. The Dividend Notes are subject to mandatory redemption in an amount equal to the Net Proceeds from the sale of any real property owned by the Company or any of its subsidiaries. Net Proceeds means the gross cash received by the Company from any such sale reduced by the sum of (a) costs relating to the sale, (b) federal and state income taxes as a result of the sale, and (c) the amount used by the Company to pay in whole or in part financial institution debts secured by a mortgage of the Company's or any subsidiary's real property regardless of whether such mortgage encumbers the property sold. The Company has obligated itself not to grant any mortgages on any of its property located in the Capitol Center District in Providence, Rhode Island, other than Parcels 3S and 5, and to cause its subsidiaries not to grant any such mortgages, in each case without the consent of the holders of two-thirds of the outstanding principal face amount of the Dividend Notes. The Dividend Notes contain other customary terms and conditions. On June 15, 2016, the Company redeemed 10 percent of the face value of its outstanding Dividend Notes (\$1,179,000) to note holders of record on June 2, 2016. At September 30, 2016, the remaining balance is \$10,608,000. Interest payments on an annual basis after the partial redemption total \$530,000.

*Petroleum storage facility:*

On May 1, 2014, the Company entered into a Petroleum Storage Services Agreement (the Agreement) with Sprague Operating Resources, LLC (Sprague) for the lease of its entire storage capacity of 1,004,000 barrels for a term of five years. The base rent is \$3,500,000, subject to annual cost-of-living adjustments on May 1 of each year. On May 1, 2016, the annual rent increased \$39,000. In addition, the Company will receive an additional \$.15 for each barrel of throughput at the facility in excess of 3,500,000 barrels in any contract year (May 1 to April 30). The total throughput for the years ended April 30, 2016 and 2015 did not exceed 3,500,000 barrels. Sprague had the right to extend the Agreement for two additional terms of five years each, provided that Sprague gives at least twelve months' notice prior to the expiration of the initial or the extension term, as applicable. Commencing April 1, 2016 and on each April 1 thereafter during the initial term and any extension term, either party during the following thirty days had the right to terminate the Agreement as of April 30 of the year next following the year in which notice of termination is given. On April 28, 2016, the Company received notice from Sprague that, effective April 30, 2017, Sprague is terminating the Agreement. The Company is reviewing its options for the petroleum storage facility upon termination of the Sprague lease.

Commencing May 1, 2015, Sprague is obligated to reimburse the Company for any real property taxes in excess of \$290,000. For the year 2016, there was an increase in the assessment and a decrease in the rate, resulting in no additional payment being due from Sprague. There was no increase in the assessment or tax rate for the year 2015 and therefore no additional payment was due from Sprague.

During the first nine months of 2016, the Company's operating activities provided \$1,942,000 of cash which was \$28,000 more than the cash provided by operating activities for the nine months ended September 30, 2015. At September 30, 2016, cash increased \$746,000 from year-end.

Historically, the Company has had adequate liquidity to fund its operations.

*Cash and cash commitments:*

At September 30, 2016, the Company had cash of \$2,971,000. The Company and its three subsidiary companies each maintain a checking account in the same bank, each of which accounts is insured by the Federal Deposit Insurance Corporation to a maximum of \$250,000. The Company periodically evaluates the financial stability of the financial institution at which the Company's funds are held.

On April 1, 2016, under the terms of the long-term land lease on Parcel 9, the scheduled annual contractual rent increased \$18,000. On May 1, 2016, under the terms of the Agreement with Sprague, the annual rent increased \$39,000.



**Table of Contents**

At September 30, 2016, the Company has three tenants occupying 54 percent of the Steeple Street Building under short-term leases (five years or less) at a current annual rental of \$125,000. The Company is currently marketing the remaining portions of the building for lease.

In light of the extraordinary dividend paid in December 2012, at each of the quarterly Board meetings held in 2015 and 2016, the Board of Directors voted to omit the regular quarterly dividend of \$0.03 per share. The Board will review the declaration of future dividends on a quarterly basis. The declaration of future dividends will depend on future earnings and financial performance.

**3. Results of operations:****Three months ended September 30, 2016 compared to three months ended September 30, 2015:***Leasing segment:*

	2016	2015	Difference
Leasing revenues	\$ 1,242,000	\$ 1,249,000	\$ (7,000)
Leasing expense	193,000	207,000	\$ (14,000)
	\$ 1,049,000	\$ 1,042,000	

Leasing revenue decreased due to the termination of a lease at the Steeple Street Building, offset in part by scheduled increases in rentals under long-term land leases. Leasing expense decreased due to a decrease in repairs and maintenance at the Steeple Street Building and a decrease in insurance premiums was offset in part by an increase in the City of Providence real estate taxes.

*Petroleum storage segment:*

	2016	2015	Difference
Petroleum storage facility revenues	\$ 892,000	\$ 883,000	\$ 9,000
Petroleum storage facility expense	648,000	561,000	\$ 87,000
	\$ 244,000	\$ 322,000	

Petroleum storage facility revenues increased due to a scheduled cost-of-living rent adjustment under the Sprague lease effective May 1, 2016. Petroleum storage facility expense increased due to increases in repairs and maintenance expense and legal fees incurred in connection with consideration of strategic alternatives for the Terminal, offset in part by a decrease in insurance premiums.

*General:*

For the three months ended September 30, 2016, general and administrative expense increased \$39,000 due to an increase in legal fees incurred in connection with the partial redemption of the Dividend Notes.

*Interest expense:*

For the three months ended September 30, 2016 and 2015, the interest expense, Dividend Notes was \$132,000 and \$147,000, respectively. The interest on the Dividend Notes decreased due to the partial redemption payment of \$1,179,000 made on June 15, 2016. In November 2015, the Company paid the bank loan in full. The interest expense, bank loan for the three months ended September 30, 2015 was \$14,000.

**Nine months ended September 30, 2016 compared to nine months ended September 30, 2015:***Leasing segment:*

	2016	2015	Difference
Leasing revenues	\$ 3,860,000	\$ 3,763,000	\$ 97,000
Leasing expense	622,000	653,000	\$ (31,000)
	\$ 3,238,000	\$ 3,110,000	

Leasing revenue increased due to scheduled increases in rentals under long-term land leases, offset in part by a decrease in the percentage rent under the Lamar lease and the termination of a lease at the Steeple Street Building. Leasing expense decreased due to a decrease in repairs and maintenance at the Steeple Street Building and a decrease in insurance premiums, offset in part by an increase in the City of Providence real estate taxes.

**Table of Contents***Petroleum storage segment:*

	2016	2015	Difference
Petroleum storage facility revenues	\$ 2,664,000	\$ 2,638,000	\$ 26,000
Petroleum storage facility expense	1,814,000	1,865,000	\$ (51,000)
	\$ 850,000	\$ 773,000	

Petroleum storage facility revenues increased due to a scheduled cost-of-living rent adjustment under the Sprague lease effective May 1, 2016 and miscellaneous reimbursements. Petroleum storage facility expense decreased due to lower depreciation expense due to certain assets becoming fully depreciated in 2015 and a decrease in insurance premiums, offset in part by legal fees incurred in connection with consideration of strategic alternatives for the Terminal.

*General:*

For the nine months ended September 30, 2016, general and administrative expense increased \$113,000 due to an increase in legal fees and costs associated with the partial redemption payment on the Dividend Notes.

*Interest expense:*

For the nine months ended September 30, 2016 and 2015, the interest expense, dividend notes was \$445,000 and \$442,000, respectively. In November 2015, the Company paid the bank loan in full. The interest expense, bank loan for the nine months ended September 30, 2015 was \$62,000.

**Table of Contents**

**Item 4. Controls and Procedures**

As required by Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act ), the Company carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's principal executive officer and the Company's principal financial officer. Based upon that evaluation, the principal executive officer and the principal financial officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

There was no significant change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to affect, the Company's internal control over financial reporting. The Company continues to enhance its internal controls over financial reporting, primarily by evaluating and enhancing process and control documentation. Management discusses with and discloses these matters to the Audit Committee of the Board of Directors and the Company's independent auditors.

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 6. Exhibits**

**(b) Exhibits:**

**3.1** Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the registrant's report on Form 8-K filed on April 24, 2013).

**3.2** By-laws, as amended, April 26, 2016 (incorporated by reference to Exhibit 3.2 to the registrant's quarterly Report on Form 10-Q for the quarter ended June 30, 2016)

**10** Material contracts:

**(a) Petroleum Storage Services Agreement between Sprague Operating Resources LLC and Company:**

(i) Dated April 18, 2014 (incorporated by reference to Exhibit 10(a) to the registrant's quarterly report on Form 10-Q for the quarter ended March 31, 2014)

**(b) Form of Dividend Note:**

(i) Dated December 27, 2012 (incorporated by reference to Exhibit 10.2 to the registrant's report on Form 8-K filed on December 27, 2012)

**(c) Lease between Metropark, Ltd. and Company:**

(i) Dated January 1, 2005 (incorporated by reference to Exhibit 10(a) to the registrant's annual report on Form 10-KSB for the year ended December 31, 2004), as amended.

**31.1** Rule 13a-14(a) Certification of President and Principal Executive Officer

**31.2** Rule 13a-14(a) Certification of Treasurer and Principal Financial Officer

**32.1** Certification of President and Principal Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**32.2** Certification of Treasurer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**101** The following financial information from the Company's Quarterly Report on Form 10-Q for the Quarter ended September 30, 2016, filed with the Securities and Exchange Commission on November 8, 2016, formatted in eXtensible Business Reporting Language:

- (i) Consolidated Balance Sheets as of September 30, 2016 and December 31, 2015
- (ii) Consolidated Statements of Income for the Three Months and Nine Months ended September 30, 2016 and 2015
- (iii) Consolidated Statements of Cash Flows for the Nine Months ended September 30, 2016 and 2015
- (iv) Notes to Consolidated Financial Statements.

Table of Contents

SIGNATURE

In accordance with the requirements of the Exchange Act, the Issuer caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CAPITAL PROPERTIES, INC.

By /s/ Robert H. Eder  
Robert H. Eder  
President and Principal Executive Officer

By /s/ Barbara J. Dreyer  
Barbara J. Dreyer  
Treasurer and Principal Financial Officer

DATED: November 8, 2016