

CAPITAL PROPERTIES INC /RI/

Form 10-Q

November 01, 2010

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q**

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

**For the quarterly period ended September 30, 2010**

**OR**

**o 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 02914**

(Address of principal executive offices) (Zip Code)

**(401) 435-7171**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

|   |   |
|---|---|
| Title of each class   | Name of each exchange on which registered |
| <b>Class A Common Stock, \$.01 par value</b>                | <b>OTCQX (Pink Sheets)</b>                |
| Securities registered pursuant to Section 12(g) of the Act: |   |
| NONE  |   |

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<br>filer <input type="checkbox"/> | Accelerated filer <input type="checkbox"/> | Non-accelerated filer <input type="checkbox"/> | Smaller reporting<br>company <input type="checkbox"/> |
| (Do not check if a 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, 2010, the Company had 3,727,724 shares of Class A Common Stock and 2,872,188 shares of Class B Common Stock outstanding.



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FORM 10-Q  
FOR THE QUARTER ENDED SEPTEMBER 30, 2010  
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CAPITAL PROPERTIES, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS**

|   | September 30,<br>2010<br>(unaudited) | December 31,<br>2009 |
|---|--------------------------------------|----------------------|
| <b>ASSETS</b>   |                                      |                      |
| Properties and equipment (net of accumulated depreciation)  | \$ 22,300,000                        | \$ 22,069,000        |
| Cash  | 2,387,000                            | 2,315,000            |
| Income taxes receivable   | 424,000                              | 47,000               |
| Prepaid and other   | 571,000                              | 331,000              |
|   | \$ 25,682,000                        | \$ 24,762,000        |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |                                      |                      |
| <b>Liabilities:</b>   |                                      |                      |
| Note payable (\$300,000 due within one year)  | \$ 5,900,000                         | \$                   |
| <b>Accounts payable and accrued expenses:</b>   |                                      |                      |
| Property taxes  | 267,000                              | 243,000              |
| Tank repairs  | 177,000                              |                      |
| Environmental remediation   | 81,000                               | 81,000               |
| Other   | 286,000                              | 514,000              |
| <b>Deferred:</b>  |                                      |                      |
| Leasing revenues  | 445,000                              | 520,000              |
| Income taxes, net   | 5,442,000                            | 5,305,000            |
|   | 12,598,000                           | 6,663,000            |
| <b>Shareholders equity:</b>   |                                      |                      |
| Class A common stock, \$.01 par; authorized 10,000,000 shares; issued and outstanding, 3,727,724 shares at September 30, 2010 and 3,654,739 shares at December 31, 2009 | 37,000                               | 37,000               |
| Class B common stock, \$.01 par; authorized 3,500,000 shares; issued and outstanding, 2,872,188 shares at September 30, 2010 and 2,945,173 shares at December 31, 2009  | 29,000                               | 29,000               |
| Excess stock, \$.01 par; authorized 1,000,000 shares; none issued and outstanding   |                                      |                      |
| Capital in excess of par  | 11,762,000                           | 11,762,000           |
| Retained earnings   | 1,256,000                            | 6,271,000            |
|   | 13,084,000                           | 18,099,000           |

\$ 25,682,000      \$ 24,762,000

See notes to consolidated financial statements.

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**CAPITAL PROPERTIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS**  
**(Unaudited)**

|  | Three Months Ended |              | Nine Months Ended |              |
|--|--------------------|--------------|-------------------|--------------|
|  | September 30       |              | September 30      |              |
|  | 2010               | 2009         | 2010              | 2009         |
| Revenues:  |                    |              |                   |              |
| Leasing  | \$ 839,000         | \$ 714,000   | \$ 2,329,000      | \$ 2,188,000 |
| Petroleum storage facility   | 976,000            | 950,000      | 2,865,000         | 2,835,000    |
|  | 1,815,000          | 1,664,000    | 5,194,000         | 5,023,000    |
| Expenses:  |                    |              |                   |              |
| Leasing  | 255,000            | 266,000      | 819,000           | 673,000      |
| Petroleum storage facility   | 873,000            | 591,000      | 2,004,000         | 1,815,000    |
| General and administrative   | 214,000            | 224,000      | 706,000           | 714,000      |
| Interest   | 91,000             |              | 155,000           |              |
|  | 1,433,000          | 1,081,000    | 3,684,000         | 3,202,000    |
| Income before income taxes   | 382,000            | 583,000      | 1,510,000         | 1,821,000    |
| Income tax expense:  |                    |              |                   |              |
| Current  | 80,000             | 190,000      | 316,000           | 712,000      |
| Deferred   | 35,000             | 52,000       | 137,000           | 30,000       |
|  | 115,000            | 242,000      | 453,000           | 742,000      |
| Net income   | 267,000            | 341,000      | 1,057,000         | 1,079,000    |
| Retained earnings, beginning   | 1,187,000          | 5,971,000    | 6,271,000         | 5,629,000    |
| Dividends on common stock based upon<br>6,599,912 shares outstanding (\$.03 per share for<br>the three months ended September 30, 2010 and<br>2009; \$.92 and \$.09 per share for the nine<br>months ended September 30, 2010 and 2009,<br>respectively) | (198,000)          | (198,000)    | (6,072,000)       | (594,000)    |
| Retained earnings, ending  | \$ 1,256,000       | \$ 6,114,000 | \$ 1,256,000      | \$ 6,114,000 |
| Basic income per common share based upon<br>6,599,912 shares outstanding   | \$ .04             | \$ .05       | \$ .16            | \$ .16       |

See notes to consolidated financial statements.



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**CAPITAL PROPERTIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009**  
**(Unaudited)**

|   | 2010         | 2009         |
|---|--------------|--------------|
| Cash flows from operating activities:   |              |              |
| Net income  | \$ 1,057,000 | \$ 1,079,000 |
| Adjustments to reconcile net income to net cash provided by operating activities:                       |              |              |
| Depreciation  | 577,000      | 519,000      |
| Amortization of deferred financing fees   | 2,000        |              |
| Deferred:   |              |              |
| Income taxes  | 137,000      | 30,000       |
| Leasing revenues  | (75,000)     |              |
| Other, principally net changes in prepaids, accounts payable, accrued expenses and current income taxes | (253,000)    | (569,000)    |
| Net cash provided by operating activities   | 1,445,000    | 1,059,000    |
| Cash used in investing activities, payments for properties and equipment                                | (1,146,000)  | (1,172,000)  |
| Cash flows from financing activities:   |              |              |
| Proceeds from note payable  | 6,000,000    |              |
| Payments:   |              |              |
| Note payable  | (100,000)    |              |
| Deferred financing fees   | (55,000)     |              |
| Dividends   | (6,072,000)  | (594,000)    |
| Net cash used in financing activities   | (227,000)    | (594,000)    |
| Increase (decrease) in cash   | 72,000       | (707,000)    |
| Cash, beginning   | 2,315,000    | 3,395,000    |
| Cash, ending  | \$ 2,387,000 | \$ 2,688,000 |
| Supplemental disclosures:   |              |              |
| Cash paid for:  |              |              |
| Income taxes  | \$ 743,000   | \$ 1,138,000 |
| Interest  | \$ 125,000   | \$           |

Non-cash investing and financing activities:

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|  |           |            |
|--|-----------|------------|
| Capital expenditures financed through accounts payable       | \$ 30,000 | \$ 368,000 |
| Conversion of Class B Common Stock into Class A Common Stock | \$        | \$ 4,000   |

See notes to consolidated financial statements.

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**CAPITAL PROPERTIES, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009**

**(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: (1) Leasing and (2) 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), 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 ) and the Wilkesbarre Pier (the Pier ), collectively referred to as the Facility, located in East Providence, Rhode Island, for Global Companies, LLC ( Global ) 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; whereas the Company is responsible for the operating and maintenance expenditures, including a portion of the real property taxes, 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, 2009, 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 generally accepted accounting principles 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 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, 2010, the results of operations for the three and nine months ended September 30, 2010 and 2009, and cash flows for the nine months ended September 30, 2010 and 2009.

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

*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 has not identified any standards that it believes merit further discussion. The Company expects that none of the new standards would have a significant impact on its consolidated financial statements.

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The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 financial statements. Estimates also affect the reported amounts of revenue 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,<br>2010 | December 31,<br>2009 |
|---|-----------------------|----------------------|
| Properties on lease or held for lease:    |                       |                      |
| Land and land improvements                | \$ 4,690,000          | \$ 4,621,000         |
| Building and improvements, Steeple Street | 1,890,000             | 1,772,000            |
| Construction in progress                  | 2,847,000             | 2,246,000            |
|   | 9,427,000             | 8,639,000            |
| Petroleum storage facility, on lease:     |                       |                      |
| Land and land improvements                | 5,591,000             | 5,591,000            |
| Buildings and structures                  | 1,764,000             | 1,744,000            |
| Tanks and equipment                       | 14,588,000            | 14,600,000           |
|   | 21,943,000            | 21,935,000           |
| Office equipment                          | 83,000                | 131,000              |
|   | 31,453,000            | 30,705,000           |
| Less accumulated depreciation:            |                       |                      |
| Properties on lease or held for lease     | 190,000               | 104,000              |
| Petroleum storage facility, on lease      | 8,904,000             | 8,430,000            |
| Office equipment                          | 59,000                | 102,000              |
|   | 9,153,000             | 8,636,000            |
|   | \$ 22,300,000         | \$ 22,069,000        |

At September 30, 2010, the Company wrote off fully depreciated equipment no longer in service totaling \$60,000.

In June 2009, the Company commenced the construction of the historic restoration and utility infrastructure of the Steeple Street Building, which was completed in October 2010 at a total cost of \$2,977,000 plus tenant improvements of \$191,000.

**5. Note payable:**

In April 2010, the Company borrowed \$6,000,000 from a bank. The loan bears interest at the rate of 6 percent per annum and has a term of ten years with repayments on a twenty-year amortization schedule (monthly principal payments of \$25,000 plus interest). The loan matures April 26, 2020 and contains the customary covenants, terms and conditions and permits prepayment, in whole or in part, at any time without penalty if the prepayment is made from internally generated funds. As collateral for the loan, the Company granted the bank a mortgage on Parcels 3S and 5 in the Capital Center.

In May 2010, the proceeds from the loan were used principally to fund a special dividend of \$5,478,000 to shareholders, which represented the Company's earnings and profits as calculated for federal income tax purposes at December 31, 2009.

In connection with the borrowing, the Company incurred financing fees totaling \$55,000, which are included in prepaid and other assets on the accompanying consolidated balance sheet at September 30, 2010. These fees are being amortized on a straight-line basis over the 10-year term of the note and are included in interest expense on the accompanying consolidated statements of income and retained earnings for the three and nine months ended September 30, 2010.

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**6. Description of leasing arrangements:**

*Long-term land leases:*

As of September 30, 2010, the Company had entered into six long-term land leases for six separate parcels upon which the improvements have been completed ( developed parcels ). In addition, in 2005 a long-term land lease commenced on an undeveloped parcel on which two residential buildings were planned. One building was completed in September 2009. The other building has not progressed beyond the early stages of site preparation and the timing of its construction and completion is uncertain.

Under the seven land leases, the tenants are required to negotiate any tax stabilization treaty or other arrangements, appeal any changes in real property assessments, and pay real property taxes assessed 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 and retained earnings. The real property taxes attributable to the Company's land under these leases totaled \$378,000 and \$878,000, respectively, for the three and nine months ended September 30, 2010, and \$178,000 and \$898,000, respectively, for the three and nine months ended September 30, 2009.

Under the lease which commenced in 2005, the tenant is entitled to a credit for future rents equal to a portion of the real property taxes paid by the tenant through April 2007. In connection with Phase I of the tenant's project, commencing July 1, 2010, the annual rent increased from \$48,000 to \$300,000. As a result of the rent credit, the tenant will not be required to make cash payments for rent until May 2012. Commencing July 1, 2010, the Company is reclassifying each month \$25,000 of deferred leasing revenues to leasing revenues. At September 30, 2010, the remaining credit is \$445,000.

*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, Ltd. under a short-term cancellable lease.

A former tenant of the Steeple Street Building filed for receivership in November 2009. At December 31, 2009, the former tenant owed the Company \$40,000 and the Company recorded an allowance for doubtful accounts of \$40,000. At March 31, 2010, the former tenant owed the Company an additional \$22,000 and the Company recorded an allowance for doubtful accounts for the additional amount. In June 2010, the former tenant sold its operations to a new tenant who assumed the lease and paid the Company in full; the Company reversed the allowance for doubtful accounts for the full amount.

At September 30, 2010, the Company has two tenants in a portion of the Steeple Street Building (including the new tenant who assumed the lease) under short-term leases (five years or less) at a current annual rental of \$114,000. The Company is seeking additional tenants for the remaining available space.

**7. Petroleum storage facility:**

*Environmental incident (2010):*

On August 30, 2010, during a regular facility inspection of the Terminal a release of petroleum-contaminated water was discovered from the tank bottom of one of the Company's 150,000 barrel tanks. The Company notified the Rhode Island Department of Environmental Management (RIDEM), the Environmental Protection Agency and the United States Coast Guard. It also notified its insurance carriers of the release and the damage to the tank.

The tank was emptied of product and the cleaning of the tank bottom was completed by September 11, 2010. The petroleum-contaminated water released from the tank was contained on the secondary containment liner under the tank bottom, preventing contamination of the groundwater. The Company engaged an outside engineering firm to inspect the tank bottom to determine the cause and location of the release, as well as the extent of the required repairs. The findings of the inspection indicated that aggressive corrosion from inside the tank occurred, causing two holes in the immediate vicinity of the observed release, as well as several other holes or potential holes in other areas of the tank bottom. The report indicates that the corrosion was caused by microbial contamination.

The Company has received from the contractor who constructed the tank in 2004 a cost estimate of \$150,000 to repair the tank. Once the repair begins, it will take approximately six weeks to complete. Management's present estimate of the total cost of the cleanup, inspection and repair is \$210,000 (of which \$33,000 has been paid through



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September 30, 2010), which amount is included in petroleum storage facility expenses on the accompanying consolidated statements of income and retained earnings for the three and nine months ended September 30, 2010.

At this time, management does not know which costs, if any, will be recovered under its insurance policies; however, the Company has filed a claim under the property policy with its insurance carrier to recover the repair costs. The deductibles on the Company's insurance policies are \$50,000 for environmental and \$75,000 for property. In addition, the Company is reviewing all of the facts and circumstances to determine if it has a claim against third parties for costs of cleanup, inspection and repair. However, the Company has determined that no receivable can be recorded at this time.

The Company is in the process of testing its other tanks to determine the presence of corrosive microbial contaminants but does not expect to receive the test results until December 2010.

*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 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, on October 20, 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 and remanded the proposed penalty to RIDEM for recalculation. In November 2008, Power Test appealed the decision to the Rhode Island Superior Court. In addition, in November 2008, Power Test sought, and received, a stay of the Decision and Order of the Hearing Officer pending a clarification by RIDEM of the amount of the proposed fine. On October 2, 2009, RIDEM issued a recalculated administrative penalty, and, subsequently, the RIDEM Hearing Officer issued a recommended amended decision, which was affirmed as a final decision by the RIDEM Director on December 23, 2009. On January 20, 2010, Power Test appealed that decision to Superior Court. There can be no assurance that the Superior Court will affirm the final 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. 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 have 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 has amended its Complaint to add Getty Petroleum Marketing, Inc. as a defendant. The parties are now engaged in discovery. There can be no assurance that the Company will prevail in this litigation.

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.

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 additional costs since then. RIDEM has not 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. While the Company and its consulting engineers believe that the proposed active remediation system will correct the situation, it is possible

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that RIDEM could require the Company to expand remediation efforts, which could result in the Company incurring additional costs.

**8. Income taxes:**

The income tax provision for the three and nine months ended September 30, 2010, does not bear the customary relationship between tax expense and pretax accounting income. The Company has determined that certain expenditures in connection with the historic restoration of the Steeple Street Building qualify for federal historic income tax credits in 2010 of approximately \$500,000 and has incorporated the credit in determining the effective tax rate for 2010 in the accompanying consolidated financial statements.

**9. Operating segment disclosures:**

The Company operates in two segments: (1) Leasing and (2) 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 income and 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 nine months ended September 30, 2010 and 2009:

|                                     | 2010         | 2009         |
|-------------------------------------|--------------|--------------|
| <i>Leasing:</i>                     |              |              |
| Revenues:                           |              |              |
| Long-term leases:                   |              |              |
| Contractual                         | \$ 1,746,000 | \$ 1,595,000 |
| Contingent                          | 93,000       | 99,000       |
| Short-term leases                   | 490,000      | 494,000      |
| Total revenues                      | \$ 2,329,000 | \$ 2,188,000 |
| Property tax expense                | \$ 401,000   | \$ 366,000   |
| Depreciation                        | \$ 86,000    | \$ 32,000    |
| Income before income taxes          | \$ 1,510,000 | \$ 1,515,000 |
| Assets                              | \$ 9,495,000 | \$ 7,900,000 |
| Properties and equipment, additions | \$ 788,000   | \$ 1,383,000 |

*Petroleum storage:*

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|   |               |               |
|---|---------------|---------------|
| Revenues:   |               |               |
| Contractual   | \$ 2,865,000  | \$ 2,833,000  |
| Contingent  |               | 2,000         |
| Total revenues  | \$ 2,865,000  | \$ 2,835,000  |
| Property tax expense  | \$ 177,000    | \$ 161,000    |
| Depreciation  | \$ 486,000    | \$ 482,000    |
| Income before income taxes                                    | \$ 861,000    | \$ 1,020,000  |
| Assets  | \$ 13,489,000 | \$ 14,106,000 |
| Properties and equipment:                                     |               |               |
| Additions   | \$ 20,000     | \$ 67,000     |
| Write-off of fully depreciated equipment no longer in service | \$ 12,000     | \$            |

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The following is a reconciliation of the segment information to the amounts reported in the accompanying consolidated financial statements for the nine months ended September 30, 2010 and 2009:

|  | 2010         | 2009         |
|--|--------------|--------------|
| Revenues for operating segments:                   |              |              |
| Leasing  | \$ 2,329,000 | \$ 2,188,000 |
| Petroleum storage                                  | 2,865,000    | 2,835,000    |
| Total consolidated revenues                        | \$ 5,194,000 | \$ 5,023,000 |
| Property tax expense:                              |              |              |
| Property tax expense for operating segments:       |              |              |
| Leasing  | \$ 401,000   | \$ 366,000   |
| Petroleum storage                                  | 177,000      | 161,000      |
|  | 578,000      | 527,000      |
| Unallocated corporate property tax expense         | 2,000        | 2,000        |
| Total consolidated property tax expense            | \$ 580,000   | \$ 529,000   |
| Depreciation:                                      |              |              |
| Depreciation for operating segments:               |              |              |
| Leasing  | \$ 86,000    | \$ 32,000    |
| Petroleum storage segment:                         | 486,000      | 482,000      |
|  | 572,000      | 514,000      |
| Unallocated corporate depreciation                 | 5,000        | 5,000        |
| Total consolidated depreciation                    | \$ 577,000   | \$ 519,000   |
| Income before income taxes:                        |              |              |
| Income before income taxes for operating segments: |              |              |
| Leasing  | \$ 1,510,000 | \$ 1,515,000 |
| Petroleum storage                                  | 861,000      | 1,020,000    |
|  | 2,371,000    | 2,535,000    |
| Unallocated corporate expenses                     | (706,000)    | (714,000)    |
| Interest expense                                   | (155,000)    |              |
| Total consolidated income before income taxes      | \$ 1,510,000 | \$ 1,821,000 |
| Assets:  |              |              |
| Assets for operating segments:                     |              |              |
| Leasing  | \$ 9,495,000 | \$ 7,900,000 |
| Petroleum storage                                  | 13,489,000   | 14,106,000   |

|   |                      |                      |
|---|----------------------|----------------------|
|   | 22,984,000           | 22,006,000           |
| Corporate cash  | 2,249,000            | 2,529,000            |
| Other unallocated amounts   | 449,000              | 83,000               |
| <b>Total consolidated assets</b>  | <b>\$ 25,682,000</b> | <b>\$ 24,618,000</b> |
| Properties and equipment:   |                      |                      |
| Additions to properties and equipment for operating segments:                           |                      |                      |
| Leasing   | \$ 788,000           | \$ 1,383,000         |
| Petroleum storage   | 20,000               | 67,000               |
| <b>Total consolidated additions</b>   | <b>\$ 808,000</b>    | <b>\$ 1,450,000</b>  |
| Write-off of fully depreciated equipment no longer in service:                          |                      |                      |
| Operating segment, petroleum storage  | \$ 12,000            | \$                   |
| Unallocated   | 48,000               |                      |
| <b>Total consolidated write-off of fully depreciated equipment no longer in service</b> | <b>\$ 60,000</b>     | <b>\$</b>            |

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**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, and the Notes to Consolidated Financial Statements, 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; 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; 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, 2009. There have been no changes to the application of this accounting policy since December 31, 2009.

*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 are required to construct buildings thereon, with the exception of a parking garage), 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 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.

The petroleum storage segment consists of operating the Facility located in East Providence, Rhode Island, for Global.

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; whereas the Company is responsible for the operating and maintenance expenditures, including a portion of the real property taxes, as well as capital improvements at the Facility.

**2. Results of operations:**

**Three months ended September 30, 2010 compared to three months ended September 30, 2009:**

*Leasing segment:*

|                  | 2010       | 2009       | Difference  |
|------------------|------------|------------|-------------|
| Leasing revenues | \$ 839,000 | \$ 714,000 | \$ 125,000  |
| Leasing expense  | 255,000    | 266,000    | \$ (11,000) |
|                  | \$ 584,000 | \$ 448,000 |             |



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Leasing revenue increased due to the termination of the rent relief granted Lamar and Metropark in 2009 (which rents have been restored to their scheduled level) and scheduled increases in rentals under long-term land leases. Leasing expense decreased due to lower legal fees in connection with two leases offset in part by depreciation on the Steeple Street Building and an increase in real property taxes.

*Petroleum storage segment:*

|                                     | 2010       | 2009       | Difference |
|-------------------------------------|------------|------------|------------|
| Petroleum storage facility revenues | \$ 976,000 | \$ 950,000 | \$ 26,000  |
| Petroleum storage facility expense  | 873,000    | 591,000    | \$ 282,000 |
|                                     | \$ 103,000 | \$ 359,000 |            |

Petroleum storage facility revenues increased due to the May 1, 2010 annual cost-of-living adjustment of \$82,000 under the lease for the petroleum storage facility. Petroleum storage facility expense increased due to higher levels of scheduled repairs and maintenance and costs of \$210,000 recorded in connection with the leak in a tank in August 2010.

*General:*

For the three months ended September 30, 2010, general and administrative expense remained at the 2009 level.

*Interest expense:*

In April 2010, the Company borrowed \$6,000,000 from a bank. The loan bears interest at the rate of 6 percent per annum and has a term of ten years with repayments on a twenty-year amortization schedule (monthly principal payments of \$25,000 plus interest). For the three months ended September 30, 2010, interest expense was \$91,000.

*Income taxes:*

The income tax provision for the three months ended September 30, 2010, does not bear the customary relationship between income tax expense and pretax accounting income. The Company has determined that the expenditures in connection with the historic restoration of the Steeple Street Building qualify for federal historic income tax credits in 2010 of approximately \$500,000 and has incorporated the credit in determining the effective tax rate for 2010.

**Nine months ended September 30, 2010 compared to nine months ended September 30, 2009:***Leasing segment:*

|                  | 2010         | 2009         | Difference |
|------------------|--------------|--------------|------------|
| Leasing revenues | \$ 2,329,000 | \$ 2,188,000 | \$ 141,000 |
| Leasing expense  | 819,000      | 673,000      | \$ 146,000 |
|                  | \$ 1,510,000 | \$ 1,515,000 |            |

Leasing revenue increased due to the termination of the rent relief granted Lamar and Metropark in 2009 (which rents have been restored to their scheduled level) and scheduled increases in rentals under long-term land leases.

Leasing expense increased due to higher legal fees in connection with two leases, an increase in property taxes, depreciation on the Steeple Street Building and the hiring of a new employee. These increases were offset in part by the reversal of an allowance for a doubtful account of \$62,000.

*Petroleum storage segment:*

|                                     | 2010         | 2009         | Difference |
|-------------------------------------|--------------|--------------|------------|
| Petroleum storage facility revenues | \$ 2,865,000 | \$ 2,835,000 | \$ 30,000  |
| Petroleum storage facility expense  | 2,004,000    | 1,815,000    | \$ 189,000 |
|                                     | \$ 861,000   | \$ 1,020,000 |            |

Petroleum storage facility revenues increased due to the May 1, 2010 annual cost-of-living adjustment of \$82,000 under the lease for the petroleum storage facility. Petroleum storage facility expense increased due to costs of \$210,000 recorded in connection with the leak in a tank in August 2010 and the hiring of a new employee offset in part by lower legal fees and insurance costs.

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*General:*

For the nine months ended September 30, 2010, general and administrative expense remained at the 2009 level.

*Interest expense:*

In April 2010, the Company borrowed \$6,000,000 from a bank. The loan bears interest at the rate of 6 percent per annum and has a term of ten years with repayments on a twenty-year amortization schedule (monthly principal payments of \$25,000 plus interest). For the nine months ended September 30, 2010, interest expense was \$155,000.

*Income taxes:*

The income tax provision for the nine months ended September 30, 2010, does not bear the customary relationship between income tax expense and pretax accounting income. The Company has determined that the expenditures in connection with the historic restoration of the Steeple Street Building qualify for federal historic income tax credits in 2010 totaling approximately \$500,000 and has incorporated the credit in determining the effective tax rate for 2010.

**3. Liquidity and capital resources:**

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

In April 2010, the Board of Directors of the Company declared a special dividend of \$5,478,000 (\$.83 per common share) on the Class A and Class B common stock to shareholders of record on May 12, 2010 payable on May 26, 2010. The dividend represented the payout to the shareholders of the Company's earnings and profits as calculated for federal income tax purposes at December 31, 2009. The Company has expressed its intention in the future to convert to a pass-through entity for income tax purposes. In order to effectuate such a conversion, the Company will be required to pay out its accumulated earnings and profits. The Board of Directors determined that it would be in the best interest of the shareholders to make the distribution of the earnings and profits while the tax laws are still favorable, since management expects that the federal income tax rate on dividends may rise substantially on January 1, 2011.

In order to fund the special dividend, the Company borrowed \$6,000,000 from a bank. The loan bears interest at the rate of 6 percent per annum and has a term of ten years with repayments on a twenty-year amortization schedule (monthly principal payments of \$25,000 plus interest). The loan matures April 26, 2020 and contains the customary covenants, terms and conditions and permits prepayment, in whole or in part, at any time without penalty if the prepayment is made from internally generated funds. As collateral for the loan, the Company granted the bank a mortgage on Parcels 3S and 5 in the Capital Center.

During the first nine months of 2010, the Company's operating activities provided an additional \$1,445,000 of cash. The Company made cash payments of \$6,072,000 for dividends, \$1,146,000 principally for the restoration of the Steeple Street Building and \$100,000 in principal payments on the note payable. Cash increased \$72,000 for the nine months.

*Cash and cash commitments:*

At September 30, 2010, the Company had cash of \$2,387,000. Since February 2009, the Company maintains all of its cash in a non-interest bearing checking account.

In July 2009, the Company received notice from the holder of the leasehold mortgage on Parcel 8 that the Parcel 8 tenant was in default. A foreclosure sale was held on September 1, 2009, and the building was sold to the leasehold mortgagee. Under the terms of the Parcel 8 long-term land lease, upon the foreclosure of the leasehold mortgage, the Company is required to enter into a new long-term lease with the leasehold mortgagee or its assignee on substantially the same terms and conditions as the existing lease for Parcel 8. No new lease has been entered into to date. In such circumstances, the new tenant is required to cure any prior monetary defaults. The rent has continued to be paid in a timely fashion, and the Company has no reason to believe that the leasehold mortgagee will not continue to pay the rent and property taxes to the City of Providence in a timely fashion.

Under the terms of the Company's long-term land leases, appraisals of the premises are periodically required at various stated intervals to provide the basis for recalculating the annual rent. The appraisal process for Parcel 8 commenced in November 2009 and the final appraisal was completed in September 2010, resulting in an annual increase of \$47,000 retroactive to February 1, 2010.

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Under the lease which commenced in 2005, the tenant is entitled to a credit for future rents equal to a portion of the real property taxes paid by the tenant through April 2007. In connection with Phase I of the tenant's project, commencing July 1, 2010, the annual rent increased from \$48,000 to \$300,000. As a result of the rent credit, the tenant will not be required to make cash payments for rent until May 2012. Commencing July 1, 2010, the Company is reclassifying each month \$25,000 of deferred leasing revenues to leasing revenues. At September 30, 2010, the remaining credit is \$445,000.

Under the Company's long-term land lease on Parcel 9, on April 1, 2011, the scheduled contractual rent will increase \$260,000 annually. Under the Company's long-term land lease on Parcel 2, on May 1, 2011, the scheduled contractual rent will increase \$384,000 annually.

The current economic conditions have had limited impact on the Company's results of operations to date. In 2009, the Company had decreased Metropark's rent under the short-term parking lease from April 1, 2009 to June 30, 2010. In 2009, the Company also granted Lamar rent relief under its long-term land lease for various billboard locations for the period January 1, 2009 to May 31, 2010. Effective July 1, 2010, both rents have been restored to the scheduled level (a total increase of \$93,000 annually). As none of the Company's leases require the tenant to provide financial information, the Company has no information concerning the impact of current economic conditions on its major tenants and, therefore, cannot predict whether any other tenants will request such relief or concessions.

In June 2009, the Company commenced the construction of the historic restoration and utility infrastructure of the Steeple Street Building, which was completed in October 2010 at a total cost of \$2,977,000 plus tenant improvements of \$191,000. The Company has determined that certain expenditures qualify for Federal historic tax credits in 2010 totaling approximately \$500,000.

A former tenant of the Steeple Street Building filed for receivership in November 2009. At December 31, 2009, the former tenant owed the Company \$40,000 and the Company recorded an allowance for doubtful accounts of \$40,000. At March 31, 2010, the former tenant owed the Company an additional \$22,000 and the Company recorded an allowance for doubtful accounts for the additional amount. In June 2010, the former tenant sold its operations to a new tenant who assumed the lease and paid the Company in full; the Company has reversed the allowance for doubtful accounts for the full amount.

At September 30, 2010, the Company has two tenants in a portion of the Steeple Street Building (including the new tenant who assumed the lease) under short-term leases (five years or less) at a current annual rental of \$114,000. The Company is currently marketing the remaining portions of the building for lease.

Under the Company's lease with Global, the annual cost-of-living adjustment was \$82,000 effective May 1, 2010.

On August 30, 2010, during a regular facility inspection of the Terminal a release of petroleum-contaminated water was discovered from the tank bottom of one of the Company's 150,000 barrel tanks. The Company notified the Rhode Island Department of Environmental Management (RIDEM), the Environmental Protection Agency and the United States Coast Guard. It also notified its insurance carriers of the release and the damage to the tank.

The tank was emptied of product and the cleaning of the tank bottom was completed by September 11, 2010. The petroleum-contaminated water released from the tank was contained on the secondary containment liner under the tank bottom, preventing contamination of the groundwater. The Company engaged an outside engineering firm to inspect the tank bottom to determine the cause and location of the release, as well as the extent of the required repairs. The findings of the inspection indicated that aggressive corrosion from inside the tank occurred, causing two holes in the immediate vicinity of the observed release, as well as several other holes or potential holes in other

areas of the tank bottom. The report indicates that the corrosion was caused by microbial contamination.

The Company has received from the contractor who constructed the tank in 2004 a cost estimate of \$150,000 to repair the tank. Once the repair begins, it will take approximately six weeks to complete. Management's present estimate of the total cost of the cleanup, inspection and repair is \$210,000 (of which \$32,000 has been paid through September 30, 2010), which amount is included in petroleum storage facility expenses on the accompanying consolidated statements of income and retained earnings for the three and nine months ended September 30, 2010.

At this time, management does not know which costs, if any, will be recovered under its insurance policies; however, the Company has filed a claim under the property policy with its insurance carrier to recover the repair costs. The deductibles on the Company's insurance policies are \$50,000 for environmental and \$75,000 for property. In addition, the Company is reviewing all of the facts and circumstances to determine if it has a claim against third parties for costs of cleanup, inspection and repair. However, the Company has determined that no receivable can be recorded at this time.

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The Company is in the process of testing its other tanks to determine the presence of corrosive microbial contaminants but does not expect to receive the test results until December 2010.

On October 26, 2010, the Company declared a quarterly dividend of \$198,000 (\$.03 per common share) which dividend will be paid on November 24, 2010. The declaration of future dividends and the amount thereof will depend on the Company's future earnings, financial factors and other events.

The Company expects that cash generated from current operations will continue to be sufficient to meet operating expenses, debt service, ordinary capital expenditures and the current level of quarterly dividends. In the event temporary liquidity is required, the Company believes that a line of credit or other arrangements could be obtained by pledging some or all of its unencumbered assets as collateral.

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**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 auditors.



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**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 annual report on Form 10-K for the year ended December 31, 2008).
- 3.2** By-laws, as amended (incorporated by reference to Exhibit 3.2 to the registrant's annual report on Form 10-K for the year ended December 31, 2007).
- 10** Material contracts:
- (a) Loan Agreement between Bank Rhode Island and Company:**
- (i) Dated April 26, 2010 (incorporated by reference to Exhibit 10.1 to the registrant's report on Form 8-K filed on April 28, 2010).
- (b) 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.
- (c) Miscellaneous contract:**
- (i) Option Agreement to Purchase Real Property and Related Assets, dated June 9, 2003, by and between Dunellen, LLC and Global Companies, LLC (incorporated by reference to Exhibit 10(b)(i) to the registrant's Report on Form 10-QSB/A for the quarterly period ended June 30, 2003), 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

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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 1, 2010