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	**05-0386287**
(State or other jurisdiction of incorporation or organization)	(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
Class A Common Stock, $.01 par value	**OTCQX (Pink Sheets)**

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 þ No o

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 o No o

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 o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

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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PART I

Item 1. Consolidated Financial Statements

CAPITAL PROPERTIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	September 30, 2010 (unaudited)	December 31, 2009
ASSETS		
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
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Note payable ($300,000 due within one year)	$ 5,900,000	$
Accounts payable and accrued expenses:		
Property taxes	267,000	243,000
Tank repairs	177,000	
Environmental remediation	81,000	81,000
Other	286,000	514,000
Deferred:		
Leasing revenues	445,000	520,000
Income taxes, net	5,442,000	5,305,000
	12,598,000	6,663,000
Shareholders equity:		
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 September 30		Nine Months Ended 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 6,599,912 shares outstanding ($.03 per share for the three months ended September 30, 2010 and 2009; $.92 and $.09 per share for the nine months ended September 30, 2010 and 2009, 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 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:		

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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3. Use of estimates:

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, 2010	December 31, 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

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 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
Leasing:		
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:		

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	$

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: