

CAPITAL PROPERTIES INC /RI/
Form 10-Q
October 27, 2017
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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, 2017

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.)

5 Steeple Street, Unit 303

Providence, Rhode Island
(Address of principal executive offices)

02903
(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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act.

As of September 30, 2017, the Company had 6,599,912 shares of Class A Common Stock outstanding.

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	September 30, 2017 (unaudited)	December 31, 2016
ASSETS		
Properties and equipment (net of accumulated depreciation)	\$ 9,000,000	\$ 9,127,000
Cash and cash equivalents	5,498,000	3,124,000
Prepaid and other	268,000	184,000
Assets held for sale (Note 10)		11,195,000
	\$ 14,766,000	\$ 23,630,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Dividend notes payable (Note 5)	\$	\$ 10,608,000
Property taxes	224,000	224,000
Other	304,000	164,000
Income taxes payable	75,000	63,000
Deferred taxes, net	853,000	1,078,000
Liabilities associated with discontinued operations (Notes 8 and 10)	491,000	4,422,000
	1,947,000	16,559,000
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	11,971,000	6,223,000
	12,819,000	7,071,000
	\$ 14,766,000	\$ 23,630,000

See notes to consolidated financial statements.

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	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Revenues	\$ 1,260,000	\$ 1,242,000	\$ 3,890,000	\$ 3,860,000
Expenses:				
Operating	376,000	193,000	888,000	622,000
General and administrative	407,000	369,000	1,558,000	1,161,000
Interest on dividend notes		132,000	112,000	445,000
	783,000	694,000	2,558,000	2,228,000
Income from continuing operations before income taxes	477,000	548,000	1,332,000	1,632,000
Income tax expense (benefit):				
Current	215,000	244,000	689,000	676,000
Deferred	(37,000)	12,000	(225,000)	(22,000)
	178,000	256,000	464,000	654,000
Income from continuing operations	299,000	292,000	868,000	978,000
Income (loss) from discontinued operations, net	(38,000)	237,000	(331,000)	669,000
Gain on sale of discontinued operations, net of \$3,430,000 of taxes			5,210,000	
Net income	\$ 261,000	\$ 529,000	\$ 5,747,000	\$ 1,647,000
Basic income per common share based upon 6,599,912 shares outstanding				
Continuing operations	\$.04	\$.04	\$.13	\$.15
Discontinued operations		.04	(.05)	.10
Gain on sale of discontinued operations			.79	
Total basic income per common share	\$.04	\$.08	\$.87	\$.25

See notes to consolidated financial statements.

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	2017	2016
Cash flows from operating activities:		
Continuing operations:		
Income from continuing operations	\$ 868,000	\$ 978,000
Adjustments to reconcile income from continuing operations to net cash provided by operating activities, continuing operations:		
Depreciation	138,000	156,000
Deferred income taxes	(225,000)	(22,000)
Income taxes payable	12,000	(66,000)
Other, principally net changes in prepaids, property tax payable and other	57,000	148,000
Net cash provided by operating activities, continuing operations	850,000	1,194,000
Net cash provided by (used in) operating activities, discontinued operations	(7,651,000)	748,000
Net cash provided by (used in) operating activities	(6,801,000)	1,942,000
Cash flows from investing activities:		
Continuing operations, purchases of properties and equipment		
	(11,000)	(11,000)
Discontinued operations:		
Purchases of properties and equipment		(6,000)
Sale of assets	19,794,000	
	19,794,000	(6,000)
Net cash provided by (used in) investing activities	19,783,000	(17,000)
Cash flows from financing activities:		
Redemption of dividend notes payable		
	(10,608,000)	(1,179,000)
Increase in cash and cash equivalents	2,374,000	746,000
Cash and cash equivalents, beginning	3,124,000	2,225,000
Cash and cash equivalents, ending	\$ 5,498,000	\$ 2,971,000
Supplemental disclosures:		
Cash paid for:		

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Income taxes:		
Continuing operations	\$ 654,000	\$ 1,336,000
Discontinuing operations, sale of assets	6,418,000	
	\$ 7,072,000	\$ 1,336,000
Interest	\$ 156,000	\$ 295,000

See notes to consolidated financial statements.

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CAPITAL PROPERTIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016

(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) for many years operated in two segments, leasing and petroleum storage. On December 20, 2016, the Company's Board of Directors authorized the sale of the Company's petroleum storage facility and related assets, including the Wilkesbarre Pier and petroleum transmission pipelines owned or controlled by the Company's subsidiaries, Capital Terminal Company and Dunellen, LLC, to Sprague Operating Resources, LLC, a subsidiary of Sprague Resources, LP (collectively referred to as Sprague) for \$23 Million subject to certain adjustments. The Company concluded that the sale of the petroleum storage facility met the criteria of a discontinued operation in conformity with United States generally accepted accounting principles (GAAP) and therefore the petroleum storage segment is reported as a discontinued operation for all periods presented. On January 24, 2017, the Company and Sprague entered into a definitive purchase and sale agreement (the Sale Agreement). The sale closed on February 10, 2017. See Note 10.

The Board's decision to authorize the sale to Sprague, which had been exclusively leasing the petroleum storage facility and related assets since May 1, 2014, was based on an evaluation of the facility's economic future as solely a distillate terminal and the significant capital investment and substantial risk related to converting the facility to gasoline in order to increase revenue. The Board concluded that a sale to Sprague was in the best interest of the Company's shareholders. As a result of the sale of its petroleum storage and related assets, the Company's operations are limited to leasing its real estate interests.

The Company's continuing operations consist 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 the parking garage and Parcel 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 to Metropark, Ltd.

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, 2016, 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 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, 2017 and the results of operations for the three and nine months ended September 30, 2017 and 2016, and cash flows for the nine months ended September 30, 2017 and 2016.

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

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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.

Cash and cash equivalents:

For purposes of the statements of cash flows, the Company considers all highly liquid deposits purchased with a maturity of three months or less to be cash equivalents.

Retrospective adjustment:

Certain amounts in the consolidated financial statements for 2016 have been retrospectively adjusted as described in Note 10 hereof.

Recent accounting pronouncements:

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*. The new standard eliminates the current requirement for organizations to present deferred tax liabilities and assets as current and noncurrent in a classified balance sheet. Instead, organizations will be required to classify all deferred tax assets and liabilities as noncurrent. The amendments are effective for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods. ASU 2015-17 will not affect the Company's balance sheet presentation in future periods because the Company does not present a classified balance sheet. See Note 9 herein.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset (as defined). The ASU requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with earlier application permitted. Upon adoption, the lessee and lessor will apply the new standard retrospectively to all periods presented or retrospectively using a cumulative effect adjustment in the year of adoption. The Company is still assessing the impact of adopting the ASU but expects that its leases where it is the lessor will be accounted for as operating leases similar to its current accounting. For additional information on the Company's leases, see Note 6 herein.

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 (exclusive of assets held for sale) consist of the following:

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	September 30, 2017	December 31, 2016
Properties on lease or held for lease:		
Land and land improvements	\$ 4,701,000	\$ 4,701,000
Building and improvements, Steeple Street	5,831,000	5,820,000
	10,532,000	10,521,000
Office equipment	95,000	95,000
	10,627,000	10,616,000
Less accumulated depreciation:		
Properties on lease or held for lease	1,548,000	1,413,000
Office equipment	79,000	76,000
	1,627,000	1,489,000
	\$ 9,000,000	\$ 9,127,000

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5. Dividend notes payable:

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 were unsecured general obligations of the Company.

In June 2016, the Company redeemed 10 percent of the face value of the outstanding Dividend Notes (\$1,179,000) to noteholders of record on June 2, 2016.

On February 24, 2017, following the sale of the Company's petroleum storage facility and related assets to Sprague on February 10, 2017, the Company issued a notice of mandatory redemption of 100% of the remaining Dividend Notes for a redemption price equal to the outstanding principal face amount of \$10,608,000 plus accrued interest of \$156,000. The Notes were redeemed on March 31, 2017.

6. Description of leasing arrangements:

Long-term land leases:

As of September 30, 2017, the Company had entered into ten long-term land leases. The various tenants have completed construction of improvements on seven of the parcels. On Parcel 6B, construction of a 169-unit residential complex commenced in November 2016 and is not yet completed. Parcel 6C is being used as a construction staging area for the construction on Parcel 6B. On September 28, 2017, the Company entered into a long term ground lease of Parcel 20. Under the terms of the lease, tenant possession will not occur until such time as the tenant has received all necessary approvals for construction of not less than 100,000 square feet of mixed use improvements. Prior to transfer of possession, no rent is being paid by the tenant and the Company receives all rents from existing tenants and remains responsible for all expenses, including real estate taxes, related to Parcel 20. Following tenant possession, tenant is obligated not only to pay ground rent for the parcel but also to pay the Company an additional amount for twenty years to compensate the Company for the buildings presently located on the premises.

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 these 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 \$310,000 and \$927,000 for the three and nine months ended September 30, 2017, and \$305,000 and \$910,000, respectively, for the three and nine months ended September 30, 2016.

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. The current annual rent on Parcel 6B and 6C is \$195,000 and \$200,000, respectively. The Tenant of Parcel 20 has the right to terminate the lease if it does not receive approvals for construction of its proposed improvements. The Company has not received any notice of termination with respect to any of the foregoing leases.

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, 2017 and 2016, the percentage rent totaled \$108,000 and \$118,000, respectively, which amounts are included in operating revenues on the accompanying consolidated statements of income for the nine months ended September 30, 2017 and 2016.

Other 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 ten-year lease. The Company has the right to terminate the lease as to the whole or any part of the property leased on thirty days notice in order to proceed with development, whether by sale, lease or otherwise.

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At September 30, 2017, the Company has five tenants occupying 68 percent of the Steeple Street Building under short-term leases of five years or less at a current annual rental of \$169,000. The Company recognizes the revenue from these leases on a straight-line basis over the terms of the leases. At September 30, 2017 and 2016, there was no excess of straight-line over contractual rentals. The Company also reports as revenue tenant reimbursements for common area costs and real property taxes. The Company's main office occupies 12 percent of the Steeple Street Building and the remainder of the Building is currently being marketed.

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

On February 10, 2017, the Company sold its petroleum storage facility and related assets (the Facility) to Sprague. See Note 10. The Facility had been leased to Sprague under a Petroleum Storage Services Agreement (the Services Agreement) since May 1, 2014. The annual base rent under the Services Agreement was \$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. Commencing on April 1, 2016 and each April 1 thereafter during the initial term and any extension term of the Services Agreement, either party during the following thirty days had the right to terminate the Services Agreement as of April 30 of the year next following the year in which notice of termination was given. On April 28, 2016, the Company received notice from Sprague that, effective April 30, 2017, Sprague would terminate the Services Agreement.

Commencing May 1, 2015, Sprague was 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.

The Company incurred \$108,000 in fees in connection with the execution of the Services Agreement, which amounts were being amortized using the straight-line method over the three-year non-cancellable portion of the term of the Services Agreement and were included in income (loss) from discontinued operations, net on the accompanying consolidated statements of income for the nine months ended September 30, 2017 and the three and nine months ended September 30, 2016. At March 31, 2017, the balance was fully written off.

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 certain other firms with respect to the gasoline discharge. All other parties other than Power Test and the Company were dismissed from the proceedings. On September 12, 2016, the Company and Power Test entered into a Tolling Agreement under which the statute of limitations is tolled to not later than sixty days following the implementation by Power Test of a RIDEM approved remediation plan. On September 19, 2016, the parties dismissed the litigation.

Since January 2003, the Company has not incurred significant costs in connection with this matter, other than ongoing litigation costs.

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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 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. The Company and RIDEM are working to complete a remediation plan. Pursuant to the Sale Agreement and related documentation between the Company and Sprague, the Company is required to secure an approved plan to remediate the contamination at its expense. At September 30, 2017, the Company had accrued \$436,000 to cover these costs. Any subsequent increase or decrease to the expected cost of remediation will be recorded in the Company's consolidated income statement as income or expense from discontinued operations.

9. Income taxes, continuing operations:

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, 2017	December 31, 2016
Gross deferred tax liabilities:		
Property having a financial statement basis in excess of tax basis	\$ 1,128,000	\$ 1,140,000
Insurance premiums and accrued leasing revenues	1,000	28,000
	1,129,000	1,168,000
Less deferred tax assets	276,000	90,000
	\$ 853,000	\$ 1,078,000

10. Discontinued operations:

On December 20, 2016, the Company's Board of Directors voted to authorize the sale of its East Providence petroleum storage facility and related assets, including the Pier and petroleum transmission pipelines owned or controlled by its

wholly-owned subsidiaries, Capital Terminal Company (CTC) and Dunellen, LLC (Dunellen) (Petroleum Segment) to Sprague Operating Resources, LLC for \$23 Million (the Sale Price), subject to certain adjustments. On January 24, 2017, the Company and Sprague entered into the Sale Agreement. The sale closed on February 10, 2017.

Pursuant to the Sale Agreement, the Sale Price was reduced by \$1,040,000, the estimated cost of a turning dolphin to be constructed by Sprague in order to provide access to Wilkesbarre Pier for larger vessels; \$1,725,000 of the Sale Price was placed in escrow to secure the Company s indemnity obligations under the Sale Agreement. The Company has elected to report as a gain from sale amounts held in escrow only when, and if, such amounts are released therefrom. In addition, the Company incurred normal closing adjustments, transfer taxes, investment banking and other fees, other than federal and state income taxes, of \$441,000.

In accordance with ASC 205-20, *Presentation of Financial Statements - Discontinued Operations* the Petroleum Segment is accounted for as a discontinued operation. Accordingly, the Petroleum Segment assets and liabilities that were to be sold were recorded as held for sale in 2016. The liabilities associated with the discontinued operations are separately identified on the Company s consolidated balance sheets. These liabilities were not assumed by Sprague and remain obligations of the Company until settled. The Petroleum Segment discontinued operations are reported after income from continuing operations.

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A reconciliation of the major classes of assets reported held for sale as of September 30, 2017 and December 31, 2016 is as follows:

	September 30, 2017	December 31, 2016
Carrying amounts of major classes of assets included as part of discontinued operations:		
Properties and equipment, net	\$	\$ 10,116,000
Prepaid and other		1,079,000
Total assets of the disposal group classified as held for sale on the consolidated balance sheets	\$	\$ 11,195,000

A reconciliation of the major classes of liabilities associated with the discontinued operations as of September 30, 2017 and December 31, 2016 is as follows:

	September 30, 2017	December 31, 2016
Carrying amounts of major classes of liabilities included as part of discontinued operations:		
Property taxes	\$	\$ 71,000
Accounts payable and other	55,000	715,000
Environmental remediation	436,000	459,000
Deferred income taxes, net		3,177,000
Total liabilities of the disposal group classified as associated with discontinued operations on the consolidated balance sheets	\$ 491,000	\$ 4,422,000

The operating results of the Petroleum Segment, including those related to prior years, have been retrospectively adjusted from continuing operations in the accompanying consolidated statements of income. Revenue and income before income taxes attributable to discontinued operations for the three and nine months ended September 30, 2017 and 2016 are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Revenue:	\$	\$ 892,000	\$ 364,000	\$ 2,664,000
Operating expenses	(61,000)	(574,000)	(907,000)	(1,595,000)
	(61,000)	318,000	(543,000)	1,069,000

Income (loss) from discontinued operations before income taxes				
Less income tax benefit (expense)	23,000	(81,000)	212,000	(400,000)
Income (loss) from discontinued operations, net of taxes	\$ (38,000)	\$ 237,000	\$ (331,000)	\$ 669,000

The net gain from sale of discontinued operations as of September 30, 2017, was calculated as follows:

Gain from sale of discontinued operations before income taxes	\$ 8,640,000
Less income tax expense:	
Current	6,607,000
Deferred	(3,177,000)
	3,430,000
Net gain from sale of discontinued operations	\$ 5,210,000

11. Fair value of financial instruments:

The Company believes that the fair values of its financial instruments, including cash and cash equivalents, receivables and payables, approximate their respective book values because of their short-term nature. Upon review of current market conditions and other factors, at December 31, 2016, the Company believed that the fair value of the dividend notes payable approximated their book value. The fair values described herein were determined using significant other observable inputs (Level 2) as defined by GAAP.

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12. Subsequent events:

On October 25, 2017, the Company's Treasurer and Chief Financial Officer, announced her retirement effective December 31, 2017. On the same date, the Board of Directors granted her a supplemental retirement benefit of \$200,000.

On October 25, 2017, the Board of Directors reinstated a regular quarterly dividend of \$.07 per share for shareholders of record on December 15, 2017, payable January 3, 2018.

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 collectability 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; and exposure to contamination, remediation or similar costs associated with the former 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, 2016. There have been no changes to the application of this accounting policy since December 31, 2016.

2. Liquidity and capital resources:

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

Cash and cash commitments:

At September 30, 2017, the Company had cash and cash equivalents of \$5,498,000. 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.

Under the terms of a long-term land lease on Parcel 7A, the land was appraised resulting in an increase in annual rent from \$122,000 to \$170,000. However, the increase was more than 20 percent over the existing rent. Under the terms of the lease, the annual increase effective April 1, 2017 was limited to 20 percent of the existing rent, or \$24,400, with the balance of the increase to be effective ratably over four years beginning April 1, 2018.

At September 30, 2017, the Company has five tenants occupying 68 percent of the Steeple Street Building under short-term leases (five years or less) at a current annual rental of \$169,000. The Company's main office occupies 12 percent of the Steeple Street Building and the remainder of the Building is currently being marketed.

On February 24, 2017, the Company issued a notice of mandatory redemption of the entire remaining outstanding balance of its Dividend Notes. The principal balance plus accrued interest to the date of redemption was \$10,764,000. The Company received \$19,794,000 from the sale of its petroleum storage business after giving effect to escrows, a credit to Sprague for the cost of constructing a turning dolphin adjacent to the Pier, and other

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customary closing costs. The Company estimates that the cash outlay for federal and state income taxes arising from the sale will total approximately \$6,600,000. Most of the remaining proceeds from the sale were used to effect the redemption of the Dividend Notes on March 31, 2017.

On October 25, 2017, Barbara Dreyer, the company's Treasurer and Chief Financial Officer, announced her retirement effective December 31, 2017. On the same date, the Board of Directors granted her a supplemental retirement benefit of \$200,000. Also the Board of directors elected Susan Johnson, the Company's Controller, as the Treasurer and Chief Financial Officer effective on Ms. Dreyer's retirement.

On October 25, 2017, the Board of Directors reinstated a regular quarterly dividend of \$.07 per share (\$462,000) for shareholders of record on December 15, 2017, payable January 3, 2018. The declaration of future dividends and the amount thereof will depend on the Company's future earnings, financial factors and other events.

3. Results of operations:

Three months ended September 30, 2017 compared to three months ended September 30, 2016:

Revenues increased \$18,000 over the 2016 level. Operating expenses increased \$183,000 due to increases in legal fees in connection with certain tenants and repair and maintenance costs at the Steeple Street Building, offset in part by a decrease in depreciation due to certain assets becoming fully depreciated in 2016.

General and administrative expense increased \$38,000 principally due to an additional employee and costs associated with moving the Company's principal office.

For the three months ended September 30, 2016, the interest expense on the Dividend Notes was \$132,000.

Nine months ended September 30, 2017 compared to nine months ended September 30, 2016:

Revenues increased \$30,000 over the 2016 level. Operating expenses increased \$266,000 due to increases in legal fees in connection with certain tenants, repair and maintenance costs at the Steeple Street Building, and an increase in insurance costs, offset in part by a decrease in depreciation due to certain assets becoming fully depreciated in 2016.

General and administrative expense increased \$397,000 principally due to bonuses to officers totaling \$245,000 and an additional employee, costs associated with moving the Company's principal office, and an increase in professional fees.

For the nine months ended September 30, 2017 and 2016, the interest expense on the Dividend Notes was \$112,000 and \$445,000, respectively.

For information relating to the sale of the petroleum storage facility and related assets to Sprague, see Note 10 in the Notes to Consolidated Financial Statements. Any further expenses and increases or reduction in retained liabilities relating to the petroleum storage facility and related assets will be recognized within discontinued operations.

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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 report on Form 8-K filed on April 24, 2013)
- 3.2** By-laws, as amended (incorporated by reference to Exhibit 3.2 to the registrant's report on Form 8-K filed on October 25, 2017)
- 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.
 - (d) Purchase and Sale Agreement between the Company and Sprague Operating Resources, LLC:**
 - (i)** Dated January 24, 2017 (incorporated by reference to Exhibit 2.1 to the registrant's report on Form 8-K filed on January 25, 2017)
- 31.1** Rule 13a-14(a) Certification of Chairman and Principal Executive Officer
- 31.2** Rule 13a-14(a) Certification of Treasurer and Principal Financial Officer
- 32.1** Certification of Chairman 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, 2017, filed with the Securities and Exchange Commission on October 27, 2017, formatted in eXtensible Business Reporting Language:
 - (i)** Consolidated Balance Sheets as of September 30, 2017 and December 31, 2016

- (ii) Consolidated Statements of Income for the Three and Nine Months ended September 30, 2017 and 2016
- (iii) Consolidated Statements of Cash Flows for the Nine Months ended September 30, 2017 and 2016
- (iv) Notes to Consolidated Financial Statements.

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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

Chairman and Principal Executive Officer

By /s/ Barbara J. Dreyer
Barbara J. Dreyer

Treasurer and Principal Financial Officer

DATED: October 27, 2017