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DEC. 6 1991

Decision 91-12-020 December 4, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Bell (U 1001 C) for authority pursuant to Public Utilities Code Section 851 to sell and lease back a certain portion of its facility located at 2675 Zoe Ave., Huntington Park, California.	ORIGINAL Application 91-09-025 (Filed September 12, 1991)

OPINION

Statement of Facts

By this application, Pacific Bell (PacBell) seeks authority to sell certain real property owned by it located at 2675 Zoe Avenue, Huntington Park, California, and to lease back a portion of that property for a period of approximately one year.

PacBell seeks authority to sell the land, building and improvements located at the Huntington Park address. PacBell will either sell the land outright, or in the alternative, transfer the building in a tax deferred exchange pursuant to Internal Revenue Code Section 1031.

The building to be sold or exchanged consists of a PacBell public office occupying approximately 3,000 square feet and vacant space of approximately 77,000 square feet. The terms of the sale include a provision to lease back the 3,000 square feet currently occupied by PacBell's public office for one year at $1.00 per year, in order to allow PacBell sufficient time to relocate its public office. PacBell plans to relocate its public office within the next year.

PacBell proposes that any gain on sale be initially credited to and held in Uniform System Of Accounts (USOA) Account 4360.9 (Part 32), Other Deferred Credits net of any capital gains tax. On November 26, 1990, PacBell filed with the Commission a

Petition to Modify Decision (D.) 86-01-026, wherein it requested the Commission to modify those portions of the decision pertaining to gain on sale of land to comport with the new regulatory framework adopted in D.89-10-031. In its Petition to Modify D.86-01-026, PacBell proposes that any gain on sale be accounted for in the earnings calculations and associated sharing mechanisms (when applicable) adopted in D.89-10-031. Accordingly, PacBell proposes that the Commission defer addressing the specific treatment of the gain on sale of the Huntington Park facility involved in this proceeding until after the Commission rules on PacBell's Petition for Modification of D.86-01-026. PacBell points out that since any gain on sale of the Huntington Park property will be held in USOA Account 4360.9 (Part 32), ratepayers will be fully protected.

Notice of filing of the application was published in the Commission's Daily Calendar on September 20, 1991. No protests have been filed. For that reason, no hearing is deemed necessary. In reviewing the application, the administrative law judge and assigned Commissioner's office requested of PacBell additional financial and historical information concerning the sale, which PacBell supplied.

Description of the Property to be Sold

The property to be sold consists of approximately 35,500 gross square feet of land (0.82 acre) improved with a two-story building used for general office and administrative use consisting of approximately 80,000 gross square feet, located at 2675 Zoe Avenue, Huntington Park, Los Angeles County, California. The legal description of the property is attached as Exhibit A to the application.

The original cost and current book cost of the land is $110,456. The original cost of the improvement on the land was $2,670,754, and the depreciated book cost of the building as of April 1991 is $2,098,578. The book accounting treatment associated with this sale and/or possible delayed tax-deferred exchange in conformity to Internal Revenue Code Section 1031, has previously been provided to the Commission's Division of Ratepayer Advocates in a data request response and is attached as Exhibit B to the application.

The proposed sale of the real property is to a nonaffiliated third party, and the purchase price set forth in the agreement between PacBell as seller and the third party as purchaser is $1,200,000. An appraisal of the property dated May 29, 1991, is attached to the application as Exhibit B, pp. 5-50. This appraisal indicates that the market value of the subject property is $1,155,000 on an "as is" basis as of May 17, 1991.

All property may be sold "as is," in fee, on a cash basis. PacBell does have the option, as described on page 14 of the Agreement of Purchase and Sale and Joint Escrow Instructions (Exhibit C to the application), to exchange the property in accordance with Section 1031 of the Internal Revenue Code. In either case, PacBell will not carry back a note or have the buyer assume any indebtedness to PacBell. As indicated above, PacBell will lease back approximately 3,000 square feet of the property for the period of approximately one year for the nominal rental of $1.00 per year. PacBell will not be responsible for the continued operation, control, and maintenance of the building during the lease back period.

Statutory Authority

The filing by PacBell is made pursuant to Public Utilities (PU) Code Section 851 and Commission Rules of Practice and Procedure, Rules 2-8, 15, 16, 17.1, 35, and 36.

Character of Business and Territory Served

Applicant owns and operates directly a general communications system in the State of California. The system is composed of telephone lines and exchanges, buildings, rights of way, and other equipment used to provide exchange telecommunications and exchange access service.

<u>Legal Name and Principal Place of Business</u>

The exact legal name of the applicant is Pacific Bell. The location of applicant's principal place of business is 140 New Montgomery Street, San Francisco, California 94105.

<u>Incorporation</u>

Applicant is a corporation organized and existing pursuant to the laws of the State of California. A certified copy of PacBell's articles of incorporation, as amended, was filed with the Commission on November 19, 1990.

<u>Balance Sheet and Income Statement</u>

PacBell's balance sheet as of April 30, 1991 and an income statement covering the period from April 1, 1990 to April 30, 1991 is attached as Exhibit E to the application as required by Rule 36(a) of the Commission's Rules of Practice and Procedure.

<u>Permits</u>

No franchises, permits or operative rights are pertinent to the property to be transferred pursuant to the application involved herein.

<u>Discussion</u>

This application for permission to sell the Zoe Avenue property is the first such application to be processed by this Commission since the adoption of the New Regulatory Framework (NRF) in D.89-10-031. The NRF decision did not address the criteria for disposing of gains or losses on sales of property, as discussed elsewhere in this opinion. Neither does the NRF discuss guidelines for approvals of sale of utility plant or property which is used or useful. However, one policy objective of the NRF was to provide incentives to local exchange companies to improve the efficiency of their operations. While this application is limited to scrutiny of this transaction only and as such does not provide general guidance for future sales of property under NRF, the sale of this transaction does appear consistent with improving the long-term efficiency of the company's operations and reducing the company's long-term costs.

The property which PacBell desires authority to sell or exchange is vacant with the exception of 3,000 square feet currently used by PacBell as a business office. The property no longer is suitable for PacBell's purposes and within a year, PacBell will relocate its business office currently in the building to another of PacBell's locations.

The location of the business office in the Zoe Avenue area has caused the business office to request a relocation to another area with improved security. PacBell is aware that a higher than average absentee rate occurs at that office, and believes that relocation to a more convenient area would improve the situation.

The property contained an underground diesel fuel tank which was removed by PacBell. The property also contains asbestos, which is estimated to cost $225,000 to remove. The buyer has agreed to purchase the property "as is", assuming responsibility for these expenses.

An appraisal made by an independent certified real estate appraisal firm, not affiliated with either the buyer or PacBell in June, 1990 and updated on May 29, 1991, sets the "as is" market value of the property at $1,155,000 as of May 17, 1991.

PacBell has received appraisals for the property at different times dating from 1986. The fair market value (FMV) of the property was estimated at $1.6m, 1.5m, 1.7m. in 1986, 1988, and 1990, respectively. These estimates do not include the cost of the asbestos or other hazardous material removal, which would reduce the proceeds from any sale. According to these estimates, the market for this property varies by about $100,000 from year to year, and the price fluctuates up and down. It appears unlikely that by continuing to hold the property in anticipation of a better price, PacBell would recoup the annual costs connected with the property. In the meantime, PacBell does not have an efficient use for the space.

The City of Huntington Park (the City) has met several times with PacBell about the status of the building and PacBell is aware that a future buyer will have to either provide on-site parking (4 spaces per 1,000 square feet of space) or purchase equivalent spaces from nearby city parking at the then-current cost. PacBell's use of the building is grandfathered in without conformance to the parking requirements as PacBell has owned the building for 38 years. PacBell also anticipates that the difficulty of finding a buyer, if PacBell were to hold the building in order to sell during a better real estate market, may increase if the City increases the cost of public parking spaces. A current proposal has been introduced to increase the cost of city parking, although the likelihood of approval of this proposal is unknown. Mr. Jack Wong, assistant executive director for redevelopment of the Huntington Park area, indicated to PacBell in meetings in February of 1991 that the City would likely "shut down" (not issue an occupancy permit) to any buyer if the Zoe Avenue property has no parking.

The annual property taxes on the property are approximately $52,000. It currently costs PacBell at least that much to continue to hold the building. PacBell does not have any foreseeable use for the building in their strategic plan. If PacBell held the building for several more years awaiting a rebounding of the current economy, the purchase price would have to increase by several hundred thousand dollars to justify the strategy. It appears highly uncertain that this area of Los Angeles County will appreciate by that amount in value, to justify the continued operating expenses.

The purchase price agreed to by PacBell as seller and the nonaffiliated buyer on an "as is" basis is $1,200,000. PacBell and the buyer have negotiated directly, not through an intermediary, so PacBell will not pay any commissions on the sale. Upon a sale or exchange, the property will be transferred in fee, and PacBell will not be responsible for the continued operation, control, and maintenance of the building during the approximate one-year period it leases back the 3,000 square feet of office space.

Because the depreciated book cost of the building as of April, 1991 was $2,098,578 and the current book cost of the land is $110,456, for a total land plus building cost of $2,209,034, it appears that an outright sale of the property for $1,155,000 may result in a loss, at least insofar as accounting is concerned.

Whether an exchange of property under Internal Revenue Code Section 1031 would ultimately result in a loss or gain insofar as PacBell's books are concerned depends to a great extent upon how that particular transaction would be structured. As noted elsewhere in this opinion, the exact issue as to how gains or losses are to be treated will be determined in the proceeding to modify D.86-01-026. Until that issue is resolved, any gains or losses from a sale or a Section 1031 exchange will be booked into and will remain in USOA Account 4360.9 (Part 32).

Sale or exchange of the building at the present time for a purchase price in excess of its present "as is" market value but less than its current book value may not be adverse to the interest of PacBell's ratepayers and represents sound business judgment in that PacBell will dispose of the building for slightly more than its current market value, will retain its present office space for one year at a cost of one dollar, and will be relieved of the cost of future operation, control, and maintenance of the property while a buyer willing to purchase at nearer the current book value is located, which, in view of the present state of the economy, may be a considerable period of time. PacBell is also relieved of the expense of the asbestos removal and the removal of any residual toxins from the area around the old site of the exhumed underground diesel storage tank.

As previously noted, because the issue of how gains and losses from real property sales are to be treated in ratemaking is the subject of PacBell's Petition to Modify D.86-01-026, any gain or loss on this sale or exchange should be booked into USOA Account 4360.9 (Part 32) until the Commission resolves that issue.

PacBell's application should be approved, conditioned upon PacBell booking any gain or loss from the sale or exchange into USOA Account 4360.9 (Part 32), Other Deferred Credits net of any capital gains tax pending resolution of PacBell's Petition to Modify D.86-01-026.

Applicant has requested expedited treatment of the application as the agreement of sale between PacBell and the purchaser contains a provision that time is of the essence (Exhibit C, p. 12, Item 16), and that time for closing of escrow will soon expire.

<u>Findings of Fact</u>

1. PacBell is the owner of, and desires to sell improved real property located at 2675 Zoe Avenue, Huntington Park, Los Angeles County, California which is no longer suitable for PacBell's purposes.

2. PacBell's strategic plan includes no foreseeable use for the Zoe Avenue property.

3. PacBell's bill payment office has asked to move its location for security reasons connected with the location of the payment office in the Zoe Avenue property.

4. PacBell pays $51,938 in annual property taxes on the Zoe Avenue property. This is the minimum annual cost to PacBell of holding the property, if PacBell did not sell the property at this time.

5. The real property with the existing improvements has recently been appraised by an independent appraiser as having a current "as is" market value of $1,155,000 as of May 17, 1991.

6. The fair market value (FMV) of the real property was appraised at $1.6m, $1.5m, and $1.7m in 1986, 1988, and 1990, respectively.

7. These FMV appraisals do not include the cost of asbestos removal from the property, estimated at $225,000.

8. PacBell has grandfathered rights to use of the building without on-site parking. If sold, Huntington Park city rules would require the buyer to obtain 4 parking spaces per 1,000 square feet of space.

9. Mr. Jack Wong, assistant executive director for redevelopment of the Huntington Park area, indicated to PacBell in meetings in February of 1991 that the City would likely "shut down" (not issue an occupancy permit) to any buyer if the Zoe Avenue property has no parking.

10. There is currently a proposal to increase the cost of parking spaces, although the likelihood of such a proposal's adoption by the City of Huntington Park is unknown.

11. PacBell has entered into an agreement with a nonaffiliated third party to convey the real property to the third party "as is" for a purchase price of $1,200,000 on a cash basis, or, as an option, to exchange the property in conformance with Internal Revenue Code Section 1031. The agreement further provides that PacBell will lease back approximately 3,000 square feet of office space currently utilized by it as a public office, for the period of one year at an annual rental of $1.00, to give it time to relocate the public office to another of its properties.

12. Under the agreement, PacBell will not be responsible for the continued operation, control, and maintenance of the building during the lease back period.

13. Under the agreement, the buyer obtains the building in an "as is" condition, which includes the assumption of responsibility for any asbestos or environmental clean-up.

14. Sale of the property appears not to be adverse to the interests of the ratepayers in that a current savings of operating and maintenance costs will result and because of the uncertainty of locating a buyer willing to pay a price closer to the current book value of the property. Further, PacBell will be allowed to retain its public office at the premises for one year at the nominal rental of $1.00 per year.

15. PacBell will not pay any real estate commissions as part of the transaction costs of this sale.

16. In the event of either a sale or an exchange under Internal Revenue Code Section 1031, PacBell will not carry back a note or have the purchaser assume any indebtedness to PacBell.

17. Gains or losses realized from the sale or exchange should be booked into USOA Account 4360.9 (Part 32), pending Commission resolution of the question of how gains and losses from real property sales are to be treated under the NRF adopted in D.89-10-031.

18. PacBell's application conforms to and meets the requirements of PU Code Section 851 and Rules 2-8, 15, 16, 17.1, 35, and 36 of the Commission's Rules of Practice and Procedure.

19. Time is of the essence in connection with this application.

Conclusions of Law

1. PacBell's application conforms to and meets the requirements of PU Code Section 851 and Rules 2-8, 15, 16, 17.1, 35, and 36 of the Commission's Rules of Practice and Procedure.

2. The outright sale of PacBell's real property located at 2675 Zoe Avenue, Huntington Park, California for the sum of $1,200,000 with a one-year lease back of 3,000 square feet of its current office space at a yearly rental of $1.00, or in the

alternative, an exchange of property in conformance with Section 1031 of the Internal Revenue Code is consistent with sound utility management and planning and should be approved.

3. Any gains or losses realized from the sale should be booked into in USOA Account 4360.9 (Part 32) until resolution of the question of how gains and losses from real property sales are to be treated pursuant to the NRF adopted in D.89-10-031.

4. Because time is of the essence, the order herein should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The outright sale of Pacific Bell's (PacBell) real property located at 2675 Zoe Avenue, Huntington Park, Los Angeles County, California, for the sum of $1,200,000 with a one-year lease back of 3,000 square feet of its current office space at a yearly rental of $1.00, or in the alternative, an exchange of property in conformance with Section 1031 of the Internal Revenue Code is approved.

2. Any gain or loss realized from the sale or exchange shall be booked by PacBell into USOA Account 4360.9 (Part 32) until the Commission has resolved the question of how gains and losses from real property sales are to be treated under the New Regulatory Framework adopted in D.89-10-031

This order is effective today.

Dated December 4, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY

Neal J. Shulman

NEAL J. SHULMAN, Executive Director

PB