

CALIFORNIA STATE LANDS COMMISSION

**ANNUAL STAFF REPORT ON THE MANAGEMENT
OF STATE SCHOOL LANDS**

Fiscal Year 2004-05

CALIFORNIA STATE LANDS COMMISSION

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Submitted to:

Honorable Arnold Schwarzenegger, Governor

The California State Legislature
and
The State Teachers' Retirement System

TABLE OF CONTENTS

INTRODUCTION	1
SURFACE MANAGEMENT PROGRAM.....	3
Update: California Desert Protection Act of 1994.....	3
Fiscal Year 2004-05 Activities	5
State Teachers' Retirement System Fund Revenues.....	5
Surface Rental Income and Revenues	5
School Land Bank Fund Revenues	5
City of Shasta Lake Land Sale.....	5
Ft. Irwin Road Widening Project Land Sale	5
Ft. Irwin Land Expansion Project Land Sale	6
Accrued Interest on the School Land Bank Fund.....	6
School Land Bank Fund Investments And Other Activities.....	6
Agricultural Property Investment	6
Barstow Property Development	7
Table: Summary of Revenue Generated from Surface Management Program: Fiscal Year 2004-05	8
Fiscal Year 2005-06 Planned Activities	9
Potential State Teachers' Retirement System Fund Revenues	9
Surface Rentals Income	9
Interest Income	9
Income from Timber Harvests	9
Potential School Land Bank Fund Revenues	9
CDPA/Bureau of Land Management Land Exchange....	9
El Centro 80-Acre Land Exchange	10
Mendocino County Land Exchange	10
Potential School Land Bank Fund Investments	10
Agricultural Investments	10
Barstow Property Development	11
Ground Leasing Investments	11
GEOHERMAL, SOLID MINERALS, AND OIL AND GAS PROGRAMS.....	12
Fiscal Year 2004-05 Activities	12
Geothermal Program	12
The Geysers	12
Geothermal Prospecting Permit Applications.....	13
Solid Minerals Program	14
Mineral Lease Management	14

U.S. Borax.....	14
Hanson Aggregates	15
Western Mesquite Mines.....	15
Sigma Stone	15
Protech Minerals	16
Washington Group International	16
Granite Construction	16
MolyCorp.....	16
Jacobson Construction.....	17
Mineral Lease Applications.....	17
Granite Construction	17
Bureau of Reclamation.....	17
Hi-Grade Materials	17
Cima Cinders	18
Mineral Exchange Applications.....	18
Kaiser Resources.....	18
Mineral Prospecting Permit Applications	18
Southern Clay Products	19
Abandoned Mine Reclamation Partnership	19
Oil & Gas Program	20
Round Mountain.....	20
Sulfur Crest.....	20
Reference Map for Geothermal, Solid Minerals, and Oil & Gas	21
Table: Summary of Revenue Generated from Geothermal, Solid Minerals, and Oil & Gas Programs: Fiscal Year 2004-05.....	22
Fiscal Year 2005-06 Planned Activities	23
Geothermal Program	23
The Geysers	23
Geothermal Permit Applications	23
Solid Minerals Program	23
Mineral Lease Management	23
Mineral Lease Applications.....	24
Mineral Exchange Applications.....	24
Mineral Inquiries	24
Abandoned Mine Reclamation Partnership	25
Oil & Gas Program	25
FINANCIAL SUMMARY: Fiscal Year 2004-05.....	26
ABBREVIATIONS:	27

INTRODUCTION

The California State Lands Commission (CSLC), through its State School Lands Management Program (Program) manages approximately 471,000 acres of school lands held in fee ownership by the State, and the reserved mineral interests on another 790,000± acres of school lands where the surface estate has been previously sold. Management of the Program is split between two CSLC divisions, the Land Management Division (LMD) and the Mineral Resources Management Division (MRMD). The LMD is responsible for the Surface Management Program under which all surface resources on school lands, with the exception of mineral activities, are administered. The MRMD is responsible for the Geothermal, Mineral, and Oil & Gas Programs, which involve the leasing of school lands for geothermal resources development, mining activities, and oil and gas development.

School lands were placed into a statutory trust in 1984 when the State Legislature approved the School Land Bank Act (Act), created the School Land Bank Fund (Fund), and designated the CSLC as trustee of the Fund. The Act added Sections 8700 through 8716 to the Public Resources Code (PRC), which set forth the management guidelines for the Program. The Act directs that school lands be proactively managed and enhanced to provide for an economic base in support of the public school system. PRC Section 8702 spells out specific findings and declarations made by the Legislature, emphasizing the development of school lands into a permanent and productive resource base and requiring that all transactions, including exchanges, sales, and acquisitions, be implemented for revenue generating purposes.

Pursuant to PRC Section 6217.7, all net revenues, monies, and remittances from the sale of school lands are directed to be deposited into the State Treasury to the credit of the Fund. PRC Section 6217.5 directs all net revenues derived from the use of school lands (for example, royalties, rents, and interest generated from promissory notes) be deposited into the State Treasury to the credit of the Teachers' Retirement Fund, which benefits the State Teachers' Retirement System (STRS). The CSLC has a fiduciary responsibility to protect trust assets as well as generate revenue.

The CSLC's emphasis in administering the Program has been: 1) the maximization of revenues from school lands assets, 2) the continued implementation of the California Desert Protection Act Exchange Program, and 3) protecting the corpus of the trust. Net revenue transferred to STRS during Fiscal Year 2004-05 was \$4,489,670.36, which represented an increase of 22% over the prior year net revenue. Management expenses for the Program in FY 2004-05 totaled \$1,003,178.22, which represented a 15.6% decrease from FY 2003-04 expenses. Net revenue deposited to the Fund was \$1,345,000.84, resulting in a fiscal year end balance of \$49,691,523.03. For a summary, see the table entitled "Financial Summary: Fiscal Year 2004-05" (page 26).

The *Annual Staff Report on the Management of State School Lands* is prepared pursuant to PRC Section 6477. The major activities for each of the Program components for FY 2004-05 are described in the following pages.

SURFACE MANAGEMENT PROGRAM

The Land Management Division is responsible for the Surface Management Program, which oversees all surface activities on school lands with the exception of mineral activities. These activities include land exchanges and sales of school lands parcels to public and private entities, acquisitions of lands to enhance the resource base, and issuance of leases for various purposes such as agricultural, grazing, and rights of way for roads, oil and gas pipelines, and electrical transmission lines. The objectives of the program are to manage surface uses to generate revenue, assure ongoing viability of the resource, protect the corpus of the trust, enhance local economies, and protect the environment. These goals are accomplished through management and development techniques that maximize the economic return to STRS and the Fund. For a summary of the revenues generated to STRS and the Fund through this Program, see the table entitled "Summary of Revenue Generated From Surface Management Program: Fiscal Year 2004-05" (page 8).

UPDATE: CALIFORNIA DESERT PROTECTION ACT OF 1994

On October 31, 1994, the California Desert Protection Act (CDPA) was signed into law by the President of the United States (Public Law 103-433). The CDPA designates 3.6 million acres in southern California as wilderness to be administered primarily by the Bureau of Land Management (BLM), and designates an additional four million acres in southern California to be included in the national park system.

The purpose of the CDPA is to set aside areas in the California desert to protect its natural, cultural, scenic, and historical values, and to provide for public enjoyment. 442 parcels (approximately 251,000 acres) of fee-owned school lands and over 100 parcels encumbered by the State's reservation of mineral interests were identified within the boundaries of the CDPA.

Section 707 of the CDPA provides for the exchange of the school lands located within these designated areas for other federal lands located outside of these areas. The CSLC receives compensation for the exchange of its fee and mineral interests on a value-for-value basis as determined by fair market appraisals. Compensation for the State's assets may be made in various forms including cash or exchange for other lands.

To date, there have been five CDPA land exchange transactions completed with the BLM. In the first transaction, completed in September 1996, 5,646 acres of school lands were transferred to the BLM. The value of these lands, \$992,686, was deposited into the Fund. In June 1997 a second transaction resulted in \$144,000 being deposited into the Fund after 800 acres was transferred to the BLM. The third transaction, valued at \$13,155,120, was completed in November 1997 and involved 57,309 acres of school lands that were transferred to the

BLM. In exchange, the CSLC acquired a 100-acre federal surplus parcel in Pomona and immediately sold the acquired land to the city of Pomona. While the previous two transactions were all cash, and resulted in deposits to the Fund, the Pomona sale was accomplished by the CSLC carrying a note secured by a deed of trust. Principal reduction payments were made on the note and deposited to the Fund while interest payments were transferred to the STRS Fund. A total of \$1,563,622.60 in interest was earned and credited to STRS before the note was paid off in December 2001. The fourth transaction resulted in the CSLC acquiring 658 acres of federal lands located within the Chocolate Mountains area of San Bernardino County. The lands subsequently were leased for a gold mining operation (See "Western Mesquite Mines", page 15). The CSLC has not yet compensated the BLM for the value of these lands. During FY 2003-04, a fifth CDPA land exchange involving the CSLC, the BLM, and the Metropolitan Water District of Southern California (MWD) was completed, whereby 2,560 acres of school lands were transferred to the BLM in consideration for a cash payment of \$456,900.

During FY 2004-05, work continued on a sixth CDPA land exchange, which will entail school lands worth approximately \$8.5 million. Due to a complex review and revision of the federal standards and guidelines involving federal lands transactions, progress on the sixth proposed land exchange was slowed substantially during FY 2004-05. All transactions involving federal lands now require review by the Department of the Interior in Washington, D.C. As a consequence, the time necessary to complete exchanges with the BLM has been extended. It is not expected that the sixth CDPA land exchange will be completed until FY 2006-07.

At the close of FY 2004-05, there were 326 parcels of school lands containing a total of approximately 185,400 acres within the designated national parks, monuments, preserves, and wilderness areas available to exchange with the BLM.

FISCAL YEAR 2004-05 ACTIVITIES

STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Total revenue deposited into the STRS fund from surface management activities in FY 2004-05 was \$156,281.92. This revenue was generated from the following sources and transactions:

Surface Rental Income and Revenues

Most of the 471,000± acres of school lands are isolated, landlocked parcels, with the majority being non-productive desert lands. However, close to a quarter of the total school land acreage is leased for revenue generating purposes. Rent received during FY 2004-05 from approximately 140 revenue-generating leases totaled \$150,175.97. General surface leasing involves ongoing activities, including processing new applications, re-issuing expired leases, processing lease assignments and amendments, conducting rent reviews, terminating old leases, and conducting other surface management activities. Income from the prosecution of a trespass on timbered school lands in Mendocino County generated \$970. Income from investments provided an additional \$5,135.95, which was the amount of interest collected during FY 2004-05 from the City of Shasta Lake pursuant to their purchase of a school lands parcel in FY 1999-00.

SCHOOL LAND BANK FUND REVENUES

Principal revenue from three school lands transactions (described in the following three paragraphs) totaled \$312,260.16. The total accrued interest earned on the Fund during FY 2004-05 was \$1,084,544.07. A total of \$1,345,000.84 in revenue was generated to the Fund during FY 2004-05.

City of Shasta Lake Land Sale (SA 5752)

The City of Shasta Lake made a principal payment of \$19,750.16 on its loan from the CSLC for the purchase of a school lands parcel that occurred in FY 1999-00.

Fort Irwin Road Widening Project Land Sale (SA 5758)

The County of San Bernardino purchased 11.27 acres of school lands for a road improvement project for Fort Irwin Road in San Bernardino County. The completion of this sale resulted in a deposit of \$4,510 into the Fund.

Fort Irwin Land Expansion Project Land Sale (SA 5691)

Staff completed a land sale to the U.S. Army Corps of Engineers for the expansion of Fort Irwin. The CSLC transferred title to three school lands parcels totaling 1,920 acres. \$288,000 was deposited into the Fund from this transaction.

Accrued Interest on the School Land Bank Fund

The total accrued interest earned on the Fund during FY 2004-05 was \$1,084,544.07. Accrued interest earnings increased 50% from the previous year due to the higher account balance and the higher interest rates that resulted from a general upturn in economic conditions.

SCHOOL LAND BANK FUND INVESTMENTS AND OTHER ACTIVITIES

With the enactment of the School Land Bank Act in 1984, the CSLC was given the authority, as trustee for the Fund, to select and acquire real property or any interest in real property with funds contained in the Fund with the objective of facilitating management of school lands for the purpose of generating revenue (PRC Sections 8705, 8711, and 8712). To accomplish this objective, staff has undertaken several investment studies to review and analyze potential investment alternatives for the Fund.

Agricultural Property Investment (W 25759)

In 2001, staff received a consultant's report entitled "Planning for Agricultural Land Investments in California". The report concluded that agricultural properties could be suitable investments for Fund monies and developed a set of investment criteria that would minimize risk while maximizing long-term returns. The contract with the consultant, Agland Investment Services, Inc., has been extended through May 31, 2006 to provide assistance to staff in the identification and selection of potential agricultural investments.

With the professional assistance of the consultant, staff expects to make purchase(s) of one or more agricultural properties during FY 2005-06. For further details on the progress of investment in agricultural properties, see the discussion under "Fiscal Year 2005-06 Planned Activities, Potential Land Bank Fund Investments – Agricultural Investments" (page 10).

Barstow Property Development (SA 5760)

One of the prime properties in the school lands portfolio is a 33.49± acre parcel of vacant commercial land located at the northwest corner of L Street and Interstate 15 in Barstow, San Bernardino County. In March 2004, staff received an application from Home Depot, U.S.A., Inc. (Home Depot), for the purchase of a portion of the property. After reviewing the application, staff proposed to Home Depot that the

proposed sale be offered to the public through an open bidding procedure as a Request for Proposals (RFP). During FY 2004-05, Home Depot agreed to act as the Project Nominator for the RFP, which was released early in 2005. After the



completion of the RFP, the sale was awarded to Home Depot, and the sale of a 13.95-acre portion of the parcel was nearing completion as FY 2004-05 came to a close.

For further details on the progress of the Barstow property, see the discussion under “Fiscal Year 2005-06 Planned Activities, Potential School Land Bank Fund Investments - Barstow Property Development” (page 11).

SUMMARY OF REVENUE GENERATED FROM SURFACE MANAGEMENT PROGRAM: FISCAL YEAR 2004-05

STRS FUND

Surface Rentals:

Surface Rentals:	\$	150,175.97
Timber	\$	970.00
Miscellaneous Income	\$	5,135.95
TOTAL GROSS REVENUE GENERATED TO STRS FUND:	\$	156,281.92

SCHOOL LAND BANK FUND

Land Sales:

City of Shasta Lake (SA 5752) Principal Reduction Payment	\$	19,750.16
Ft. Irwin Road Widening Project (SA 5758)	\$	4,510.00
Ft. Irwin Expansion Project (SA 5691)	\$	288,000.00
Total:	\$	312,260.16
Accrued Interest on the School Land Bank Fund:	\$	1,084,544.07
TOTAL GROSS REVENUE GENERATED TO SCHOOL LAND BANK FUND:	\$	1,396,804.23

FISCAL YEAR 2005-06 PLANNED ACTIVITIES

POTENTIAL STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Surface Rentals Income

Staff will continue to receive income from existing surface use leases and new leases (when appropriate) on school lands parcels.

Interest Income

Staff anticipates receiving income from interest on the promissory note secured by the deed of trust that the CSLC is holding for the City of Shasta Lake. At the end of FY 2004-05, the note had two remaining scheduled payments and a remaining principal of \$43,054.21. The note should be paid off by the end of FY 2005-06.

Income from Timber Harvests

There is the potential for timber income in the upcoming year from timber salvage and sanitation operations. These operations are conducted periodically due to losses from natural causes, such as fire, high winds, insect infestation and diseases. Because of the irregular nature of these operations, the amount of additional income from these sources during the coming fiscal year is difficult to predict.

POTENTIAL SCHOOL LAND BANK FUND REVENUES

Staff anticipates that new requests for land exchanges and land sales will be received throughout the coming fiscal year. Applications on the following projects currently are under consideration or are being actively processed.

CDPA/Bureau of Land Management Land Exchange (W 24480/AD 407)

Prior CDPA land exchanges between the CSLC and the BLM have resulted in an unequal balance between the value of the lands previously exchanged. Currently, the CSLC owes the BLM lands worth \$2,081,775. Additionally, the BLM has available, through the General Services Administration, approximately \$6,500,000 from surplus federal land sales that is designated for CDPA land purchases from the CSLC. The CSLC has been working with the BLM on a new proposed "Ledger Balancing Land Exchange", whereby the CSLC will transfer school lands of approximately \$8,500,000 in value to the federal government in order to eliminate the outstanding balance and facilitate the completion of the terms of the original CDPA legislation. When completed as proposed, approximately \$6,500,000 will be generated to the Fund from this transaction.

El Centro 80-Acre Land Exchange (W 26004)

Among the parcels of school lands under the authority of the CSLC is an 80-acre tract of vacant desert land located near El Centro. The parcel is landlocked and is estimated to be of relatively low value due to poor soil quality, uneven topography, and lack of legal access. Late in FY 2003-04, staff received an application from Raceland Property Holdings, LLC (Raceland) that proposed a land exchange between the CSLC and Raceland that would involve the 80-acre parcel. Under the terms of the proposed exchange, the CSLC would transfer fee title to the parcel to Raceland. In exchange, Raceland would purchase and transfer a parcel of agricultural land of equal or greater fair market value to the CSLC. The parcel acquired by the CSLC would be suitable for long term leasing and would provide income that would be deposited into the STRS account. As FY 2004-05 came to a close, this exchange was nearing completion.¹

Mendocino County Land Exchange (W 26045)

Early in 2005, staff received an application from White Cloud Resources (Whitecloud) that proposed a land exchange involving an 80-acre parcel of school land located northeast of Covelo in Mendocino County. Under the terms of the proposed exchange, the CSLC would transfer fee title to the 80-acre parcel to Whitecloud and Whitecloud would transfer a 100-acre parcel of nearby land that borders other CSLC property to the CSLC. The CSLC would benefit from the exchange because it would consolidate the CSLC's merchantable timber holdings into a more manageable tract. If the appraised fair market value of the CSLC property exceeded the fair market value of the exchange property, the CSLC also would receive a cash payment from Whitecloud that would be deposited into the Fund. Staff expects to complete this exchange in FY 2005-06.

POTENTIAL SCHOOL LAND BANK FUND INVESTMENTS

Staff has identified several property types as prime targets for the investment of Fund monies. The property types include agricultural investments, ground leasing of a commercial parcel in Barstow, San Bernardino County, and other ground leasing possibilities throughout California. In addition to these primary areas, other investment alternatives also will continue to be considered as possible investment avenues for Fund monies.

Agricultural Investments

Incorporating the guidelines and property selection screening criteria developed in the report "Planning for Agricultural Land Investments in California", staff plans to continue analyzing available agricultural investment opportunities throughout California. During FY 2003-04, staff prepared and circulated a Request For

¹ Note: This exchange was completed in December 2005. The CSLC acquired fee title to 76± acres of leased agricultural land located southwest of Niland.

Proposals (RFP) for a Farmland Advisor/Manager to assist staff in obtaining and analyzing information on specific agricultural investments and assist staff in the purchase and long-term management of the properties. In October 2003, the contract was awarded to Agland Investment Services, Incorporated (Agland). With the assistance of Agland, staff anticipates investing \$1 million to \$6 million in California agricultural land during FY 2005-06.

Barstow Property Development

As discussed earlier in this report (See "Barstow Property Development", page 7) the CSLC owns 33.49 acres of prime commercial land at the Intersection of I-15 and L Street in Barstow. The CSLC is in the process of selling a 13.95-acre portion of the property to Home Depot. The terms of the sale require Home Depot to pay \$1,500,000 to the CSLC that will be deposited into the Fund. In addition to the cash payment, Home Depot is responsible for installing all of the infrastructure improvements to service the entire 33.49-acre site. These costs are estimated to exceed \$2,500,000. Upon the conclusion of this project, staff expects to have approximately 19.79 acres of prime commercially zoned land that will be available for long-term leasing. Staff expects to begin leasing activities on the remainder property during FY 2005-06.

Ground Leasing Investments

In April 2003, pursuant to a CSLC consulting contract awarded in March 2002, staff received a report from Wallace & Steichen, Inc. entitled "Analysis of Ground Leases as an Investment Alternative". The report indicated that there are positive prospects for ground leasing as an investment option. Staff proposes to continue pursuing the possibility of investing Fund funds into long-term ground leases. Staff will research specific commercial, industrial, and/or retail land purchases where the resulting development would produce a stable, long-term income stream with low management expenses, relatively low risk, and the benefits of asset appreciation.

GEOTHERMAL, SOLID MINERALS, AND OIL & GAS PROGRAMS

The Mineral Resources Management Division is responsible for the Geothermal, Solid Minerals, and Oil & Gas Programs, which involve the leasing of school lands for geothermal resources development, mining activities, and oil and gas development. The objectives of these programs are to maximize royalty revenues, while protecting the environment and assuring public safety. All monies generated from these programs benefit the State Teachers' Retirement System (STRS).

FISCAL YEAR 2004-05 ACTIVITIES

GEOTHERMAL PROGRAM

Revenue from the geothermal program totaled \$4,980,458.91 for FY 2004-05, a 17% increase from the total for FY 2003-04. All the revenue is attributable to The Geysers geothermal field, where steam production declined by about 2% for the year, but the value of steam production increased by nearly 21%. The increased value reflects higher prices for the electricity generated from the steam.

The Geysers

The Geysers field in Sonoma and Lake counties is the site of the world's largest geothermal development. The State now has 6,862 acres of 100% reserved mineral interest school lands under lease there, plus another 360 acres of 1/16th reserved mineral interest school lands.

The State acreage provides about 25% of the steam used to generate 1,000 megawatts of electricity. The balance of the steam is produced from Federal and private leases.

Calpine Corporation, through its subsidiaries, Geysers Power Co., LLC, and Silverado Geothermal Resources, Inc., owns and operates most of the steam field and generating facilities, and is the lessee of all seven of the State's active geothermal leases.



In August 2004, the Commission issued a new lease covering 1,657 acres of reserved mineral interest school lands in the northwest part of The Geysers. The lease is the first new State geothermal lease in ten years. The lands had been under lease in the early 1980s, but were never fully explored or developed.

The new lease authorizes exploratory drilling on certain portions of the leased land, while development drilling from adjacent lands is authorized on other portions. Full development will require further approvals by the Commission and will be subject to site-specific analysis of environmental impacts as required by the California Environmental Quality Act (CEQA).

Staff also approved the conversion of two idle producing wells to injection as part of Calpine's efforts to enhance steam productivity and extend field life through injection of water into the geothermal reservoir. Water for injection is obtained from condensed steam, local creeks, and from two large wastewater pipelines. One pipeline is 29 miles in length and transports eight million gallons per day of reclaimed water from Lake County. The other pipeline is 41 miles long and carries 12 million gallons per day from the city of Santa Rosa. A system of smaller pipelines distributes water throughout The Geysers to more than 45 injection wells, 12 of which are on State leases.

Geothermal Prospecting Permit Applications

In response to the State's desire for more electrical generation from renewable sources, there has been a resurgence of interest in exploration for geothermal resources. The last period of intense interest in geothermal was about 20 years ago. In fact, the last geothermal prospecting permit approved by the Commission was in 1984. Prospecting permits can ultimately lead to new geothermal leases.

During FY 2004-05, staff continued processing an application from Deep Rose, LLC, for a geothermal prospecting permit on a 640-acre school lands parcel in Inyo County several miles north of the Coso geothermal field. The application is complete, but the permit cannot be issued by the Commission until the environmental analysis is complete. The California Division of Oil, Gas, and Geothermal Resources, as Lead Agency under the CEQA for all geothermal exploratory projects, has advised staff that the environmental documentation should be complete in the latter half of 2005. Deep Rose has proposed an exploratory well that would be one of the deepest geothermal wells ever drilled in the U.S.

Two other applications for geothermal prospecting permits remain incomplete pending submittal of viable prospecting programs and evaluation of potential environmental impacts associated with exploration. Those applications were submitted by Mack Energy Co. and Layman Energy Associates (LEA) on school lands parcels totaling 3,840 acres near Truckhaven on the western shore of the Salton Sea in Imperial County. The Applicants must apply for use permits from the county's Planning Department, which would be Lead Agency under the CEQA. Only LEA has applied for a use permit, but it is for an exploratory well on a parcel of private land, not on school lands. LEA has obtained grants from the

U.S. Department of Energy and the California Energy Commission to help fund its exploration efforts.

SOLID MINERALS PROGRAM

Revenue from the solid minerals program totaled \$126,760.19 for FY 2004-05, a 30% reduction from the total for FY 2003-04. The decrease was due to a significant reduction in production from three of four sand and gravel leases. Staff anticipates that this reduction will likely be temporary.

The solid minerals program currently has six active mineral extraction leases totaling 1,188 acres, and one active 1/16th reserved mineral interest agreement totaling 560 acres. In addition to managing these mineral properties, staff continued processing applications for four new mineral extraction leases on school lands parcels.

Mineral Lease Management

U.S. Borax (PRC 736)

U.S. Borax holds a 160-acre lease at the Gerstley Borate Mine in eastern Inyo County. The mine first operated in the 1920s and contains a unique blend of calcium and sodium borates. The mine does not comply with federal Mine Safety and Health Administration regulations and cannot be legally operated in its present configuration.

The mine openings have been sealed to protect the public and wildlife,

and prior surface disturbance has been reclaimed in accordance with a plan approved by Inyo County. U.S. Borax is consulting with engineering firms on the viability of reopening the mine as a small open pit. In the interim, U.S. Borax continues to pay a minimum annual royalty on 600 tons of production, which totaled \$21,282.00. The lease will be up for renewal in May 2007.



Hanson Aggregates (PRC 7301)

Hanson Aggregates operates a 120-acre lease for the extraction of rock, sand, and gravel (previously held by Nelson and Sloan) at the Lakeside Quarry in northern San Diego County. Royalties from this lease decreased markedly to only \$7,500, which represents the minimum required under the lease. Hanson curtailed this mining operation due to a legal dispute with the State on sand leases in San



Francisco Bay. Staff's processing of Hanson's application to extend, amend, and transfer the lease from Nelson and Sloan awaits the completion of a financial audit, agreement on final lease terms and resolution of legal issues.

Western Mesquite Mines (PRC 8039)

Western Mesquite Mines, Inc., acquired this 658-acre lease at the Mesquite Gold Mine in Imperial County from Newmont Mining through an assignment approved by the Commission in 2004. The mine first operated in 1985, but was idled in 2001 due to low gold prices and depletion of permitted reserves. Since then, Imperial County approved an expansion that includes the leased land, and gold prices have increased to over \$450 per troy ounce. Western is concluding a feasibility study on where to restart mining operations and is seeking capital for essential mining equipment including shovels and trucks.

Sigma Stone (PRC 8253)

Sigma Stone holds a 160-acre lease at the Black Angel Mine in San Bernardino County. The mine continued to be idle during most of the year due to loss of the contract miner operating Sigma's facility. Revenue however totaled \$32,577.60, which comprised the minimum annual royalty for 2005 and back payments for accounting errors for lease years 2003 and 2004. Although a competitor has seized a large share of the market for road construction materials, Sigma has prepared to resume mining as the high desert region continues to grow due to its favorable real estate prices. Sigma's rock material is marketable not only for road construction, but as decorative stone due to its lavender hue.

Protech Minerals (PRC 8322)

Protech Minerals' ten-acre lease at the Pioneer Talc Mine in San Bernardino County near the Nevada border remained idle, with activity limited to pre-development work. A minimum royalty of \$3,300 was received during the year. Protech controls other talc mines near the Pioneer Mine, and its processing plant in Victorville is the only such facility in Southern California. Pre-production work has been performed, but relatively inexpensive imported talc from China makes marketing difficult at this time.

Washington Group International (PRC 8272)

Washington Group International's (WGI) 80-acre lease in San Bernardino County yielded only the minimum royalty as the mine continued to be idle. A total of \$1,800.00 was received during FY 2004-05. An additional \$13,500 was due, but an accounting error by WGI resulted in the payment being credited to FY 2005-06. The lease's remote location limits its market to supplying material for resurfacing Interstate 40, which occurs only every five years or so. WGI, largely a construction company, is negotiating to sell the property to a mining company.

Granite Construction (PRC 7945)

Granite Construction Co. operates a large sand and gravel mine in Riverside County near Palm Desert that includes a 560-acre school lands parcel with a 1/16th reserved mineral interest. The State's royalty is \$0.04 per ton and revenues totaled \$60,400.59 for the year.

MolyCorp (W 40646)

MolyCorp extracts rare earth elements at the Mountain Pass Mine in San Bernardino County near the Nevada border. During the environmental review process for a proposed expansion of that operation, staff found that MolyCorp's proposed expansion area included about ten acres of 100% reserved mineral interest school lands. Staff has asserted the State's leasable mineral interest via correspondence with MolyCorp's legal counsel. Additional information from MolyCorp was obtained on the mineral material within the project area and its planned disposition. Field verification is necessary to determine whether a leasable interest exists.

Jacobson Construction (W 40783)

Staff continued monitoring Jacobson Construction regarding sand and gravel extraction on a 45-acre 1/16th mineral interest parcel in San Bernardino County. The material may be used to resurface and widen portions of Interstate 15 from Baker to the Nevada border and for local construction needs. Staff continued its efforts to ensure appropriate payment for the State's portion of the sand and gravel resource.

Mineral Lease Applications

Granite Construction (W 40904)

In December 2004, Granite Construction Co. applied for a negotiated mineral extraction lease on 160 acres of school lands in southwest Riverside County adjacent to Interstate 15. The State also owns a 1/16th reserved mineral interest in 151 acres immediately to the south. The application remains incomplete. Granite Construction wants to establish a quarry involving a total of 311 acres with an anticipated life of 80 years. The Liberty Quarry would supply needed sand and gravel for homes, businesses and infrastructure in the rapidly growing area. Riverside County will be the lead agency for the preparation of a CEQA document and a Mining and Reclamation Plan.

Bureau of Reclamation (PRC 6735)

Staff continued processing an application from the Bureau of Reclamation (BOR) to resume mining at the Manchester Quarry in the Dead Mountains area of San Bernardino County. The BOR proposes to quarry 2.8 million tons of rock over a 25-year period for riverbank stabilization along the Colorado River. Staff continued its coordination with the BOR, the San Bernardino County Planning Department, the State Department of Conservation's Office of Mine Reclamation (OMR), and the BLM. The OMR concluded biologic studies and prepared a Mining and Reclamation Plan for the project. Staff awaits BOR's submission of a Conditional Use Permit and Mining Permit application to San Bernardino County, lead agency for resumption of mining activities.

Hi-Grade Materials (W 40842)

Staff received a letter from Hi-Grade Materials (Hi-Grade) in March 2005 reinstating its application for a mineral extraction lease in San Bernardino County. Hi-Grade has also applied to San Bernardino County for a Mining Permit. Mining under the State lease will permit Hi-Grade to lessen an overly steep pit wall slope that abuts the State lands and also rectify a drainage diversion berm that was constructed without authorization.

Cima Cinders (W 40880)

Staff awaits completion by Cima Cinders Co. (Cima) of its lease application to extract material from a volcanic cinder deposit in the East Mojave Park in San Bernardino County. Cima's parent company extracted cinders from the school lands parcel in the 1950s, developed cinder block markets in the Las Vegas area, and provided road-surfacing materials for local county roads and State highways. Cima maintains mining claims on adjacent Federal lands within the area containing similar cinder deposits.

Mineral Exchange Applications

Kaiser Resources (W 40871)

Staff continued processing an application from Kaiser Resources to exchange a 467-acre parcel of 100% reserved mineral interest school lands for an interest in a nearby mineral estate owned by Kaiser and believed valuable for sand and gravel. Staff continued work to determine that the property does not pose an environmental risk. The lands involved are near Eagle Mountain in Riverside County where Kaiser once held a State mineral extraction lease. The lease was issued in 1978 and covered 145 acres of a 467-acre school lands parcel. The lease was within an open pit area covering several thousand acres that was mined for iron ore for nearly 40 years. Operations at the mine ceased in 1982 when air quality laws and foreign competition rendered it uneconomic. The lease expired in 1998. Kaiser has since permitted (subject to federal litigation over the adequacy of the NEPA environmental document) a 5,000-acre landfill at the Eagle Mountain complex, and plans to sell the property to the Los Angeles County Sanitation District. Kaiser has requested to extinguish the State's mineral interest to eliminate conflict with the landfill operation by proposing an exchange for mineral property with equal or higher value. On a parallel track, staff is working to seek legislation to allow a special sale of the mineral estate.

Mineral Prospecting Permit Applications

There has been little interest in prospecting for or developing precious and base metals since passage of regulations that require backfilling of mines and a tax to fund closure of abandoned mines. The 1994 CDPA and management policies on federal lands have reduced the availability of areas open to all types of mineral exploration and development. As a result, remote State school land parcels have become more important in providing open areas for mineral exploration and development. Generally, the mining industry and public are not aware of the availability of State school lands. Staff has adopted a proactive role in promoting the exploration and development of school lands to help meet the increasing

market demand for sand and gravel. In May 2005, staff made a presentation to the California Mining Association at its annual meeting, discussing the availability and procedures for prospecting and developing minerals on State-owned lands.

Southern Clay Products (PRC 8571)

In November 2004, the Commission issued a two-year mineral prospecting permit to Southern Clay Products for a school lands parcel east of Death Valley in Inyo County, near the Nevada border. Valuable clay minerals are mined in the region, and Southern Clay wants to determine the extent and economic viability of developing a clay resource believed to underlie the parcel. Shallow drilling and sampling allowed under the permit has not yet been conducted. The permit will expire in October 2006 unless extended for an additional year.

Abandoned Mine Reclamation Partnership

In 2002, in an effort to increase public safety and safeguard wildlife, the CSLC staff began cooperative efforts with the Department of Conservation Office of Mine Reclamation (OMR) to close and safeguard abandoned mines located on State school lands. In prior years, the CSLC and OMR closed two mines and fenced seven others. During FY 2004-05, the CSLC and OMR closed an abandoned mine in Kern County by backfilling the shaft with mine waste rock. The modest cost of \$1,850 was shared between the CSLC and



OMR. The event drew substantial attention from television and print media. Another project was completed in Imperial County, where two steel “bat gates” were installed at the Crown Uranium Mine to protect the public as well as a maternity colony of California leaf-nosed bats. The gates are designed to allow bat access to the mine while safeguarding the public. Entry is still available for special purposes such as future resource studies that may need to be conducted by agency personnel. OMR funded the \$10,700 contract with Frontier Environmental Solutions to perform the work. Staff contributed CEQA work, mitigation monitoring, project management and post construction work documentation for various agencies. Additional mine inventory work with OMR is ongoing to determine other school land parcels that may possess abandoned mines that warrant similar work.

OIL & GAS PROGRAM

Revenue from the oil & gas program totaled \$280,509.63 for FY 2004-05, a 15% increase from the total for FY 2003-04. Although oil production decreased by nearly 13% on the two school lands parcels where the State has a 1/16th reserved mineral interest, production rates were rising as the year ended. Oil prices increased by 32% during the year, and were continuing to rise as the year came to an end. The higher oil prices allow oil & gas operators to undertake maintenance and stimulation projects, even new drilling, which might otherwise be uneconomic, thereby halting or reversing historical production rate declines.

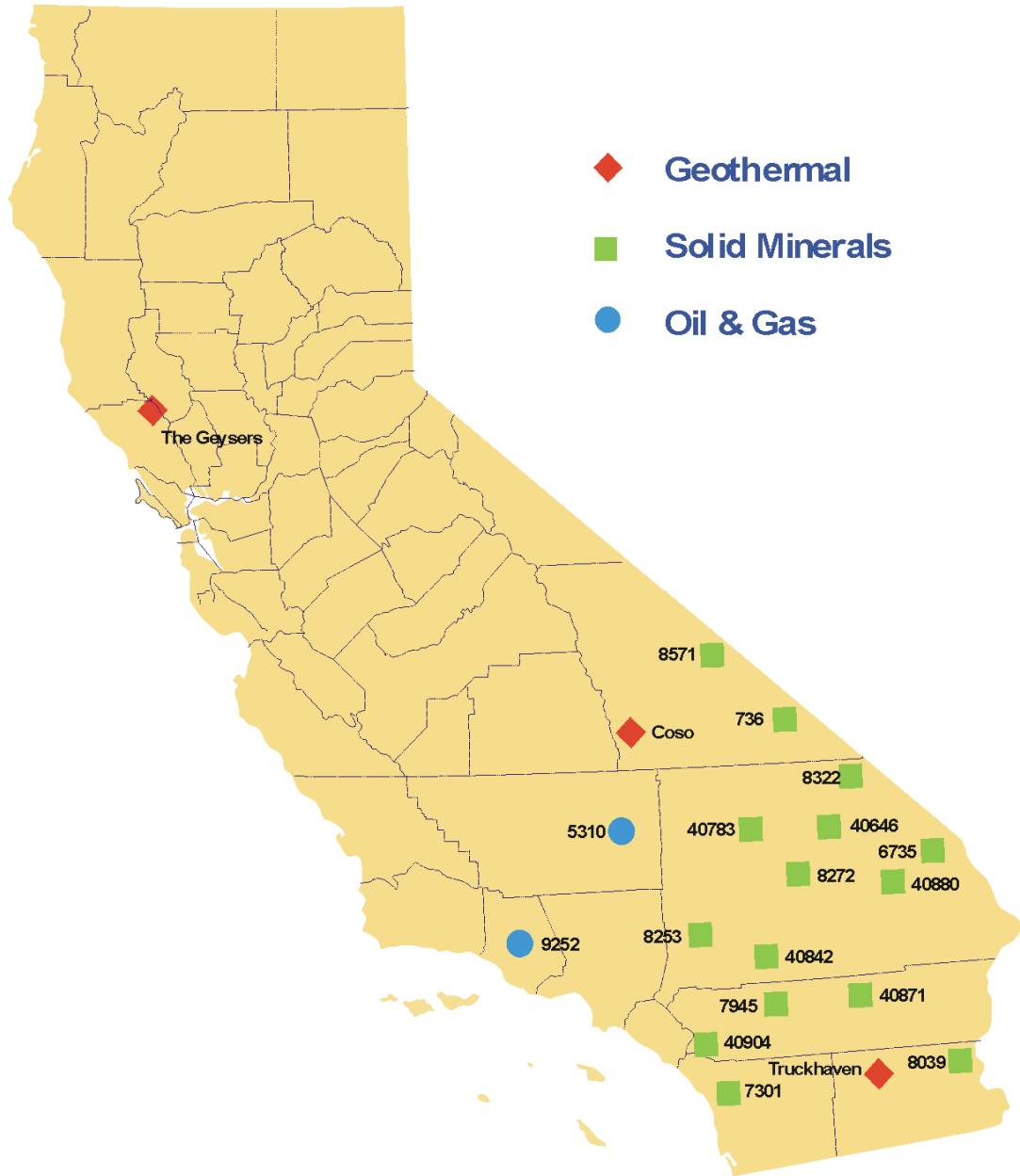
Round Mountain (VA 5310)

This 160-acre school lands parcel in the Round Mountain oil field northeast of Bakersfield in Kern County yielded \$279,843.32 in royalty. The parcel is part of a 2,363-acre unit organized in 1994 and operated by MacPherson Oil Company.

Sulfur Crest (LA 9252)

This seven-acre school lands parcel in the Sulfur Crest area of the Santa Paula oil field in Ventura County yielded \$666.31 in royalties.

REFERENCE MAP FOR GEOTHERMAL, SOLID MINERALS, AND OIL & GAS:



**SUMMARY OF REVENUE GENERATED FROM GEOTHERMAL,
SOLID MINERALS, AND OIL & GAS PROGRAMS: FISCAL YEAR 2004-05**

STRS FUND

Geothermal Royalties and Net Profits:

Royalties from leases at The Geysers:	\$ 4,217,680.68
Royalties from 1/16 th agreement at The Geysers:	\$ 10,095.89
Net Profits from lease at The Geysers:	\$ 752,682.34
Geothermal Total:	\$ 4,980,458.91

Solid Minerals Royalties:

Royalties from leases:	\$ 66,359.60
Royalties from 1/16 th agreement:	\$ 60,400.59
Solid Minerals Total:	\$ 126,760.19

Oil & Gas Royalties:

Total:	\$ 280,509.63
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TOTAL GROSS REVENUE: \$ 5,387,728.73

FISCAL YEAR 2005-06 PLANNED ACTIVITIES

GEOHERMAL PROGRAM

The Geysers

Staff estimates that royalty and net profit revenue from school lands geothermal leases at The Geysers will reach \$5.0 million in FY 2005-06, essentially the same as FY 2004-05. Steam production and steam prices are expected to remain relatively stable. No new production is anticipated in FY 2005-06 from the lease issued to Calpine's Geysers Power Co. subsidiary in 2004. However, the State will collect an annual rental of \$27,770 for that lease.

To maximize the State's future royalty revenue, staff plans to encourage development of school lands already under lease but not fully developed, and the leasing of unleased school lands. Staff will encourage its geothermal lessee to improve utilization of available steam resources through optimization of facilities and operations, and select well conversion candidates for optimal injection benefits. Staff will also continue to monitor all production operations and engineering projects on State leases and adjacent lands, verify all pricing and royalty calculations, and look for new opportunities to increase royalty revenue from school lands at The Geysers.

Geothermal Permit Applications

Staff anticipates the issuance of a geothermal prospecting permit to Deep Rose, LLC, in Inyo County in the latter part of FY 2005-06. Such a permit could lead to a geothermal lease if Deep Rose discovers a commercial resource. Staff will also continue working with applicants for prospecting permits in Imperial County to further the exploration for geothermal resources on school lands.

SOLID MINERALS PROGRAM

Mineral Lease Management

Staff anticipates several significant solid mineral projects in FY 2005-06 that will have a beneficial impact to STRS revenue. Royalty revenue from solid minerals leases is expected to reach \$200,000, exceeding the \$126,760 received in FY 2004-05 and the \$183,163 realized in FY 2003-04. The revenue is expected to rise in future years.

Increases are expected from three of four sand and gravel leases that have been largely idle the past two years. Sigma Stone's Black Angel Mine is scheduled to resume sand and gravel production in July 2005. Annual royalty from the State's lease there is expected to reach \$50,000 to \$100,000. Washington Group International's Ludlow Pit Mine will likely be assigned to a large mining company

like Granite Construction, and a large road construction contract with Caltrans for the resurfacing of Interstate 40 should occur either in FY 2005-06 or 2006-07. The owner of the Ludlow Pit should have an economic advantage to secure the contract. Should this occur, royalties approaching \$300,000 may accrue to the State over a 12 to 15-month period. Resolution of issues with Hanson Aggregates would permit the assignment, amendment and extension of the Nelson and Sloan sand and gravel lease with an annual royalty of at least \$150,000. This may occur in the second half of FY 2005-06.

Mineral Lease Applications

Staff expects the lease application from Hi-Grade Materials will be complete in mid FY 2005-06. San Bernardino County, the CEQA lead agency, will likely consider issuance of a Conditional Use Permit during the second half of the year. The Commission would consider issuance of a lease in early 2006, with mining starting during 2007.

Staff anticipates the BOR will submit its application to San Bernardino County in late 2005 to resume operations at the Manchester Quarry. Preparation of the environmental document should commence in early 2006. Commission consideration and commencement of mining may occur in FY 2006-07. Potential revenue over the 25-year life of the lease could exceed \$3 million, making it a prominent income stream for the solid minerals program.

Riverside County is the CEQA lead agency for the preparation of an environmental document for Granite Construction's proposed Liberty Quarry. The draft document should be available late in FY 2005-06. Consideration by the Riverside County should occur late in FY 2006-07. If approved by the State, substantial royalties would accrue in FY 2007-08, possibly exceeding \$1 million per year after full production is achieved.

Mineral Exchange Applications

Staff hopes to resolve negotiations with Kaiser Resources to exchange approximately 467 acres of reserved mineral interest school lands for an interest in a mineral estate owned by Kaiser in Riverside County. Should the exchange avenue prove problematic, staff is seeking legislation that will permit the sale of the mineral estate. Success of the exchange or sale hinge on successful resolution of federal litigation concerning the adequacy of the NEPA federal environmental document.

Mineral Inquiries

Staff will continue to investigate and respond to inquiries it receives concerning the availability of school land parcels for solid minerals prospecting and leasing.

Abandoned Mine Reclamation Partnership

Staff plans to continue cooperative efforts with the OMR to identify and close additional mines on school lands that may present a hazard to the public or wildlife. In FY 2005-06, the OMR will fund biologic studies and contractors for additional closures planned for Imperial, Riverside and San Bernardino Counties. To increase efficiency, staff is planning to seek Commission approval to delegate specified authority to its Executive Officer to close mines with foam plugs, backfills, bat gates or fences under specified conditions. This and other measures will streamline the process and provide more rapid resolution of possible hazards.

OIL & GAS PROGRAM

Staff estimates that royalty revenue from the two school lands oil & gas leases will approach \$400,000 during FY 2005-06, as strong crude oil prices continue to encourage field operators to undertake projects that stabilize or increase oil production rates.

FINANCIAL SUMMARY: FISCAL YEAR 2004-05

STRS FUND

REVENUES AND EXPENSES

Revenues:

Surface Rentals	\$	150,175.97
Timber.....	\$	970.00
Miscellaneous Income	\$	5,135.95
Geothermal	\$	4,980,458.91
Solid Minerals	\$	126,760.19
Oil and Gas.....	\$	280,509.63
GROSS REVENUES	\$	5,544,010.65
Less: Geothermal Resource Development Account (GRDA) Deposits.....	\$	<51,162.07>
(Public Resources Code Section 3826)		
TOTAL	\$	5,492,848.58

EXPENSES: Net Management Costs

Land Management.....	\$	360,896.92
Geothermal	\$	325,906.25
Solid Minerals	\$	383,682.47
Oil and Gas.....	\$	12,149.73
Ownership Determination	\$	49,745.59
GROSS EXPENSES	\$	1,132,380.96
Less: Reimbursement Recovery	\$	<129,202.74>
TOTAL EXPENSES	\$	1,003,178.22

NET REVENUE TO STRS \$ **4,489,670.36**

SCHOOL LAND BANK FUND

Balance as of July 1, 2004.....	\$	48,346,522.19
SMIF Interest Earned Fiscal Year 2004-05.....	\$	1,084,544.07
Revenue from Land Sales	\$	312,260.16
Less: Contracts for Investment Services.....	\$	<51,803.39>
BALANCE OF FUND AS OF JUNE 30, 2005	\$	49,691,523.03

ABBREVIATIONS

BLM	U.S. Bureau of Land Management
BOR	U.S. Bureau of Reclamation
Caltrans	California Department of Transportation
CDPA	California Desert Protection Act
CEQA	California Environmental Quality Act
CSLC	California State Lands Commission
FY	Fiscal Year
LEA	Layman Energy Associates
LLC	Limited Liability Corporation
LMD	Land Management Division
MRMD	Mineral Resources Management Division
MWD	Metropolitan Water District of Southern California
OMR	State Office of Mine Reclamation
PRC	Public Resources Code
RFP	Request for Proposals
FUND	School Land Bank Fund
STRS	State Teachers' Retirement System
USFS	U.S. Forest Service
WGI	Washington Group International