

CALIFORNIA STATE LANDS COMMISSION

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

Fiscal Year 2000-01

CALIFORNIA STATE LANDS COMMISSION

Cruz M. Bustamante, Lieutenant Governor
Kathleen Connell, State Controller
B. Timothy Gage, Director of Finance

Paul D. Thayer
Executive Officer

Submitted to
the 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 2000-01 Activities	5
State Teachers' Retirement System Fund Revenues.....	5
Surface Rentals	5
Additional Receipts	5
Interest Income	5
School Land Bank Fund Revenues	6
Cas Smith Land Sale (SA 5721)	6
Wildlife Conservation Board Conservation Easement Sale (SA 5751).....	6
City of Shasta Lake Land Sale (SA 5752)	6
Accrued Interest on the SLBF	6
School Land Bank Fund Investments And Other Activities.....	7
Agricultural Property Investment.....	7
North Coast Resource Center Investment	7
Other Investments Under Consideration.....	7
Trust Performance Measurement Study	7
Table: Summary of Revenue Generated From Surface Management Program: Fiscal Year 2000-01	8
Fiscal Year 2001-02 Planned Activities.....	9
Potential State Teachers' Retirement System Fund Revenues.....	9
Interest Income	9
Income from Timber Harvests	9
Potential School Land Bank Fund Revenues	9
CDPA/Bureau of Land Management Land Exchanges..	9
Metropolitan Water District.....	9
Bureau of Land Management.....	9
Downey Land Transaction	10
44 + Parcel Exchange	10
West Patton Village Community Services District Land Sale	10
Amargosa Canyon Land Exchange	10
Town of Apple Valley Land Sale	11
Metropolitan Water District Land Sale	11
San Bernardino County Land Sale	11

Dyer Mountain Land Transaction.....	11
United States Forest Service Land Exchange	11
Potential School Land Bank Fund Investments	12
Agricultural Property Investment Study	12
Barstow Property Development Investment Study.....	12
Ground Leasing Investment Feasibility Study.....	13
Other Investment Studies	13
GEOTHERMAL, MINERAL, AND OIL AND GAS PROGRAMS	14
Fiscal Year 2000-01 Activities	14
Geothermal Program.....	14
Geothermal Program at The Geysers.....	14
Geothermal Prospecting Permit Applications.....	15
Mineral Program.....	15
Mineral Prospecting	15
Mineral Lease Management	16
Mineral Evaluations for the California Desert Protection Act.....	17
Oil and Gas Program.....	17
Table: Summary of Revenue Generated from Geothermal, Mineral, and Oil & Gas Programs: Fiscal Year 2000-01	18
Fiscal Year 2001-02 Planned Activities	19
Geothermal Program.....	19
Geothermal Program at The Geysers.....	19
Geothermal Prospecting Permit Applications.....	19
Mineral Program.....	20
Mineral Prospecting	20
Mineral Lease Management	20
Mineral Evaluations for the California Desert Protection Act.....	21
Oil and Gas Program.....	21
FINANCIAL SUMMARY: Fiscal Year 2000-01	22

INTRODUCTION

The California State Lands Commission (CSLC), through its State School Lands Management Program (Program), manages approximately 478,000 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 sold.

School lands were placed into statutory trust in 1984 when the State Legislature approved the School Land Bank Act (Act) and designated the CSLC as trustee. The Act added Sections 8700 through 8716 to the Public Resources Code (PRC), which set forth the management guidelines for the Program and directed that school lands be proactively managed to provide for an economic base and for the generation of revenue 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. PRC Section 8711 created the School Land Bank Fund (SLBF), and designated the CSLC as the SLBF trustee.

Pursuant to PRC Section 6217.7, all net revenues, monies, and remittances from the sale of school lands are directed to be deposited in the State Treasury to the credit of the School Land Bank 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 in the State Treasury to the credit of the Teachers' Retirement Fund, which benefits the State Teachers' Retirement System (STRS). The CSLC serves as trustee for STRS. The trust creates a fiduciary relationship between the CSLC (trustee) and STRS (beneficiary), and obligates the CSLC to make school lands productive, primarily in financial terms, for the retirees, beneficiaries and disabled members of STRS. This fiduciary responsibility includes protection of trust assets as well as the generation of revenue.

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 and Gas Programs, which involve the leasing of school lands for geothermal resources development, mining activities, and oil and gas development.

The CSLC's emphasis in administering the Program has been: 1) the continued implementation of the California Desert Protection Act Exchange Program, 2) the maximization of revenues from school lands assets, and 3) achieving a balance

between school lands use and protection of the environment. The CSLC's management costs for the Program in Fiscal Year (FY) 2000-01 were \$1,299,231.38. Net revenue transferred to STRS was \$6,757,186.14. Net revenue deposited to the SLBF was \$2,307,113.93, resulting in a fiscal year end balance of \$37,080,169.88. (See "Financial Summary: Fiscal Year 2000-01" on page 22.)

The preparation of this *Annual Staff Report on the Management of State School Lands* is pursuant to PRC Section 6477. The major activities for each of the Program components for FY 2000-01 are described in the following pages.

SURFACE MANAGEMENT PROGRAM

The Surface Management Program oversees all surface activities on school lands, with the exception of mineral activities. This includes land exchanges and land sales of school lands parcels to public and private entities; issuance of leases for various purposes, such as rights of way for roads, oil and gas pipelines, and transmission lines; and grazing. It also includes the management of approximately 37,000 acres of timberland. The objectives of the program are to manage surface uses to generate revenue, enhance local economies, assure ongoing viability of the resource, and protect the environment. This is accomplished through management and development techniques that maximize the economic return to STRS and the SLBF. For complete details of the revenues generated to STRS and the SLBF through the Surface Management Program, see the table on page 8 entitled "Summary of Revenue Generated From Surface Management Program: Fiscal Year 2000-01".

In addition to the two employees new to the Surface Management Program last year, a third full-time Public Land Management Specialist was added this year. Much of this staff person's time is spent on the development of the proposed SLBF investment studies.

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 4 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. Within the boundaries of the CDPA, 442 parcels (approximately 251,000 acres) of fee-owned school lands and more than one hundred parcels encumbered by the State's reservation of mineral interests were identified.

Section 707 of the CDPA provides for the exchange of school lands inholdings within these designated areas for other federal lands. The CSLC receives compensation for the exchange of its fee and mineral interests on a value-for-value basis determined by fair market appraisals. Compensation for the State's assets may be made in various forms including cash or exchange for other lands. There are no provisions in the CDPA, however, to compensate the CSLC for staff time or contracts needed to implement the CDPA. Funding allocated for the Surface Management Program has remained relatively stable since the inception of the CDPA. The MRMD has incurred additional expense in FY 2000-01 for staff time to perform mineral evaluations.

To date, there have been four CDPA land exchange transactions with the BLM. The first, 5,646 acres valued at \$992,686, was transferred to the BLM in September 1996. The second, 800 acres valued at \$144,000, was completed in June 1997. The third exchange of 57,309 acres was facilitated by the CSLC's acquisition and subsequent sale to the City of Pomona of a 100-acre federal surplus parcel located in Pomona. The transaction was completed in November 1997 and was valued at \$13,155,120. While the previous transactions were all cash, and resulted in deposits to the SLBF, the Pomona sale was accomplished by the CSLC carrying a note secured by a deed of trust. Principal reduction payments made on the note are deposited to the SLBF while interest payments are transferred to the STRS Fund. To date, \$1,377,076 in interest payments has been earned from this note. In the fourth transaction, the CSLC received title to 658 acres of federal lands located within the Chocolate Mountains area of San Bernardino County. The lands were acquired with the intent of potentially generating revenue to STRS through gold mining activities.

A fifth CDPA land exchange involving the CSLC, BLM, and Metropolitan Water District of Southern California (MWD) is near completion. Upon the Governor executing the patent, 2,560 acres of school lands will be transferred to the BLM in consideration for cash payment of \$456,900.

Negotiations are continuing on a sixth CDPA transaction. This transaction will be structured similarly to the City of Pomona sale referenced above, but will involve federal surplus land in Downey. The BLM, General Services Administration (GSA), the National Aeronautics and Space Administration (NASA), the City of Downey, and CSLC are the parties participating in this land transaction.

At this time, prior to the completion of the Downey land transaction, there are approximately 187,000 acres of school lands remaining within the designated national parks, monuments, preserves, and wilderness areas available to exchange with the BLM.

FISCAL YEAR 2000-01 ACTIVITIES

STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Total revenue deposited into the STRS Fund from surface management activities in FY 2000-01 was \$510,119.82. This money was generated from the following transactions:

Surface Rentals

Rent received from approximately 140 revenue generating leases totaled \$175,651.61. General surface leasing activities continue by processing new applications, re-issuing expired leases (where appropriate), processing assignments and amendments, conducting rent reviews, terminating old leases, and conducting other surface management activities.

Additional Receipts

The CSLC received a refund from Sierra Pacific Industries in the amount of \$21,216.86 for undelivered seedlings originally purchased for restocking the Fourthwater Creek fire burn area, a 200-acre parcel of school lands in Plumas National Forest.

Interest Income

The CSLC had previously authorized staff to complete two separate land transactions resulting in a land sale to both the City of Shasta Lake and the City of Pomona in which the CSLC would carry notes secured by deeds of trusts for each of the two cities. Interest on the City of Shasta Lake's note for FY 2000-01 totaled \$7,665.26. The City of Pomona's interest payment was in the amount of \$304,762.09.

In addition to these interest payments, a stock dividend payment in the amount of \$824 was deposited into STRS. As a result of a 1993 bankruptcy settlement for mineral Lease No. PRC 5678.2 with Kaiser Steel Resources, Inc., the CSLC received stock interests for which it is periodically paid a dividend.

The total revenue received from the three interest payments was \$313,251.35.

SCHOOL LAND BANK FUND REVENUES

Principal revenue from three school lands transactions totaled \$146,998.50. The total accrued interest earned on the SLBF was 2,160,115.43. A total of \$2,307,113.93 in revenue was generated to the SLBF during FY 2000-01.

Cas Smith Land Sale (SA 5721)

As a result of a court settlement reached in August 1999, Smith v. State of California, Superior Court No. 72714, the CSLC was ordered to sell 320 acres of school lands within Mendocino County to L & S Investment Company (Cas Smith). A patent was issued on October 1, 1999, and the monies from the court ordered sale totaling \$32,000 were deposited into the SLBF in August 2000.

Wildlife Conservation Board Conservation Easement Sale (SA 5751)

A portion of the Cas Smith settlement, referenced above, included the sale of a conservation easement to the State of California, Wildlife Conservation Board (WCB), on approximately 115 acres of the 320 acres of school lands sold to Cas Smith. In addition to the conservation easement, the WCB was granted access rights across the remainder of the property. The purpose of the conservation easement, referred to as the Scott Creek Conservation Easement, is the preservation of old growth Douglas fir and other habitat of particular importance to wildlife. The patent was issued on October 1, 1999. Payment in the amount of \$100,000 was deposited into the SLBF in August 2000.

City of Shasta Lake Land Sale (SA 5752)

The City of Shasta Lake made a principal reduction payment in the amount of \$14,998.50 on its loan from CSLC for the purchase of a school lands parcel in FY 1999-00.

Accrued Interest on the SLBF

The total accrued interest earned on the SLBF during FY 2000-01 was \$2,160,115.43.

SCHOOL LAND BANK FUND INVESTMENTS AND OTHER ACTIVITIES

Staff has initiated several investment studies to review and analyze potential investment alternatives for the SLBF monies. Investment of SLBF monies would be made with the intention of managing and enhancing the school lands to provide an economic base for generating income to STRS.

Agricultural Property Investment

At its April 24, 2001 meeting, the CSLC authorized staff to retain an Agricultural Land Investment Consultant. A Request for Proposal (RFP) was circulated for the purposes of retaining a consultant to study the feasibility of acquiring agricultural property as an investment option for the SLBF monies. For further details on this study, see the discussion under Fiscal Year 2001-02 Planned Activities, Potential School Land Bank Fund Investments, Agricultural Property Investment Study.

North Coast Resource Center Investment

Staff is considering participating in the development of a proposed State office building in Eureka, currently referred to as the "North Coast Resource Center." The CSLC may have an opportunity to participate in the financing of this office building through the use of SLBF monies. The building would enable the Resources Agency to consolidate various offices scattered throughout the Eureka/Arcata area. The CLSC has transferred \$30,000 to the Department of General Services for a feasibility study. The findings will determine the initial space needs of participating agencies, provide an analysis of the local office rental market, and the expected level of return on investment. Should a favorable rate of return be feasible, further actions will be pursued.

Other Investments Under Consideration

At the request of the Department of General Services, the CSLC staff is conducting preliminary investigations into purchasing an office facility in the Greater Sacramento area to house other State agencies. The rent received would provide income to STRS.

Trust Performance Measurement Study

The CSLC participated with the Western States Land Commissioners Association to have Agland Investment Services, Inc., prepare a report summarizing the current theory and use of performance measures and containing recommendations for useful performance measures for the managers of public lands. The report was completed in December 2000, and its principal focus was on the financial, environmental, and social aspects of trust land management and the performance measures of each aspect.

**SUMMARY OF REVENUE GENERATED FROM SURFACE
MANAGEMENT PROGRAM: FISCAL YEAR 2000-01**

STRS FUND

Surface Rentals & Timber Harvests:

Surface Rentals: \$ 175,651.61
 Additional Receipts: \$ 21,216.86

Total: \$ 196,868.47

Interest Income from Investments:

(Interest earned on notes held on land sale transactions)

City of Shasta Lake (SA 5752): \$ 7,665.26
 City of Pomona (AD 280) \$ 304,762.09
 Lease No. PRC 5678.2 - Stock Dividend \$ 824.00

Total: \$ 313,251.35

TOTAL GROSS REVENUE GENERATED TO STRS FUND: \$ 510,119.82

SCHOOL LAND BANK FUND

Land Sales:

Cas Smith Land Sale (SA 5721)
 (320 acres)
 Revenue generated: \$ 32,000.00

Wildlife Conservation Board
 (Conservation Easement - 320 acres)
 Revenue generated: \$ 100,000.00

City of Shasta Lake (SA 5752)
 Principal Reduction Payment
 Revenue Generated: \$ 14,998.50

Total: \$ 146,998.50

Accrued Interest on the School Land Bank Fund: \$ 2,160,115.43

**TOTAL GROSS REVENUE GENERATED TO SCHOOL
LAND BANK FUND: \$ 2,307,113.93**

FISCAL YEAR 2001-02 PLANNED ACTIVITIES

POTENTIAL STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Interest Income

Staff anticipates receiving income from interest on the promissory notes secured by the deeds of trusts that the CSLC is holding for the City of Pomona and City of Shasta Lake. The anticipated closing of the Downey land transaction, early in 2002, should support further growth of interest income.

Income from Timber Harvests

The June 2001 "Ridge Fire" burned portions of two different school lands parcels (a 40-acre and 120-acre parcel) in the Covelo area of Mendocino County. Staff plans to contract with a forestry firm to assist CSLC staff in completing a fire salvage sale.

There is the potential for additional timber income in the upcoming year from timber salvage and sanitation operations resulting from inevitable fire, high wind, or insect/disease infestation. The extent of any additional income is unknown at this time.

POTENTIAL SCHOOL LAND BANK FUND REVENUES

CDPA/Bureau of Land Management Land Exchanges

Staff anticipates the ongoing exchange activity for the CDPA will continue for several more years. Staff will be working on the following CDPA exchanges in FY 2001-02:

Metropolitan Water District

Staff will complete a three-party land exchange between the CSLC, BLM and MWD. The CSLC would transfer title of four school lands parcels totaling 2,560 acres, located within federal wilderness areas, to the BLM in consideration for cash payment from MWD. In return for this payment, MWD will receive title to federal lands to include in its aqueduct facility. Upon patent issuance, \$456,900 would be deposited into the SLBF.

Bureau of Land Management

As a result of the assembled land exchange process between the CSLC and the BLM, there presently exists an unequal balance between the value of the lands previously exchanged. The BLM has indicated it will request the CSLC transfer school lands to the federal government in order

to eliminate this outstanding balance. Should this request be made, staff plans to complete a transfer of approximately 8,000 acres to the federal government to equalize the land exchange transactions previously completed. Although this transaction is not a revenue generating transaction, it is an activity processed pursuant to the CDPA and the SLBF.

Downey Land Transaction

Staff plans to continue negotiations on a proposed five-party exchange between the BLM, GSA, NASA, CSLC, and the City of Downey. The CSLC would take title to approximately 96 acres of federal GSA surplus land (a former NASA site) located in Downey, in exchange for comparable value of school lands, in accordance with the CDPA. The city would purchase the acquired land from the CSLC pursuant to the School Land Bank Act. The current proposal includes a principal down payment that would be deposited into the SLBF. A note and deed of trust would be carried by the CSLC. The interest earned on this note will be deposited into the STRS Fund.

44 + Parcel Exchange

Efforts between the CSLC and the BLM continue in identifying federal lands with mineral potential to be exchanged for CSLC inholdings with mineral potential that are located within wilderness areas and national parks. One such exchange would consist of more than 44 federally-owned parcels in the San Joaquin Valley that possess oil and gas mineral potential. These BLM administered parcels would be exchanged for CSLC inholdings of comparable value contained within certain national parks, a national preserve, and/or BLM wilderness areas. Staff plans to continue negotiating with the BLM to facilitate this land exchange.

West Patton Village Community Services District Land Sale

Staff will complete a transaction conveying a 640-acre school lands parcel in Lassen County to the West Patton Village Community Services District (WPVCSD) at a purchase price of \$75,000. WPVCSD plans on using the property for the construction of a replacement sewage treatment facility in the Herlong area.

Amargosa Canyon Land Exchange

To equalize a land exchange between the BLM, the National Park Service (NPS) and a private party who owns land within the Death Valley National Park, the BLM requested the CSLC to consider making available a school lands property located within the federal Amargosa Canyon Natural Area in Inyo County. The BLM wants to acquire the parcel because of its valuable habitat and highly

valued recreational areas. As consideration, the CSLC will receive cash for the fair market value of the school lands parcel from the private party as part of the exchange transaction. The private party will receive title to federal land. The BLM will receive title to the school lands parcel to be administered as part of the Amargosa Canyon Natural Area. The NPS will receive title to the private party's property within Death Valley National Park. Negotiations are planned to continue with the BLM, NPS, and private party on this transaction.

Town of Apple Valley Land Sale

Negotiations will continue for the sale of approximately 160 acres of school lands to the Town of Apple Valley in San Bernardino County. The town seeks this property for development of a private regional distribution center that will bring a large number of jobs and growth to the local economy.

Metropolitan Water District Land Sale

MWD made an application to acquire a 200-acre parcel of school lands near Chiriaco Summit in Riverside County. MWD proposes to include the parcel in its Hayfield Groundwater Storage Facility. MWD has contracted with a private party to prepare an appraisal of the subject property. The CSLC staff will review the report when completed and, if approved, continue with the transaction.

San Bernardino County Land Sale

The San Bernardino County Public Works Department is interested in acquiring a road right of way along the western boundary of a 40-acre school lands parcel in San Bernardino County. The county has filed an application to purchase a 40-foot wide strip of land. The county is proposing a road improvement project for the area.

Dyer Mountain Land Transaction

Staff will continue negotiations to lease, exchange, and/or sell a 480-acre school lands parcel in Plumas County. The parcel is proposed to be part of a four-season development that will include a ski resort. Staff plans to review an independent land and timber appraisal that was recently completed.

United States Forest Service Land Exchange

On June 30, 1987, the CSLC authorized a Memorandum of Understanding between the CSLC and the Pacific Southwest Region of the U.S. Forest Service (USFS). The purpose of this agreement is to facilitate the exchange of CSLC lands located within national forest boundaries (inholdings) for forested lands outside of national forest boundaries. The proposal consolidates the respective in holdings and benefits both agencies. Phase 1, which included CSLC in-holdings, primarily in southern California, was completed in 1990. Phase 2 has

been delayed due to required federal cultural and archaeological studies. The studies have recently been completed and the second phase of the exchange is now moving forward. In this phase, the CSLC would exchange its remaining national forest in-holdings for approximately 1,640 acres of land containing an estimated 55 million board feet of timber in Butte County. Staff has met several times with USFS staff to negotiate the terms and conditions of the land exchange and negotiations are continuing.

POTENTIAL SCHOOL LAND BANK FUND INVESTMENTS

The following studies have been initiated and are in addition to the ongoing consideration of financing a proposed State office building near Eureka (North Coast Resource Center). These studies involve possible agricultural property investments, ground leasing a school lands parcel in Barstow in San Bernardino County, and other ground leasing possibilities throughout California. Other investment alternatives will also be researched and studied as a possible investment of SLBF monies.

Agricultural Property Investment Study

A report entitled "Planning for Agricultural Land Investments in California", prepared by Agland Investment Services, Inc., a consultant retained to study the benefits, risks, and returns associated with investment in agricultural property, will be reviewed by staff. The report is intended to serve as the basis for determining the potential for investment of SLBF monies in agricultural property within California. The selection criteria and guidelines developed in the report for agricultural property are anticipated to be utilized in analyzing the acceptability of any specific proposed agricultural investment opportunity. Staff anticipates an initial investment of \$1 million to \$5 million in California agricultural land. A previous in-house agricultural land study and the consultant's report will be used as the basis for screening and selecting those investment properties considered for acquisition.

Barstow Property Development Investment Study

The CSLC staff acquired an approximately one-acre site adjacent to an existing 33-acre, more or less, school lands parcel located at the northwest corner of the I-15 and L Street freeway interchange in Barstow, in FY 1999-00. It is staff's opinion that the combined approximately 34-acre site has the potential for commercial development. Staff plans on seeking a real estate development consultant through an RFP to conduct a feasibility study addressing the highest and best use of the site and the potential for ground leasing the property. The consultant will prepare a report that will enable staff to design an investment plan for the parcel that could produce a significant income stream to the STRS Fund. Staff may consider the expenditure of SLBF monies if the consultant's report indicates that installation of infrastructure improvements will enhance the marketability of the site.

Ground Leasing Investment Feasibility Study

Staff proposes to continue the investigation of investment of SLBF funds into a series of long term ground leases. Staff would research commercial, industrial, and/or residential land purchases where the resulting development would produce a stable, long-term income stream with low management expense and the benefits of appreciation over time. Staff anticipates authorization from the CSLC to engage a consultant to analyze this type of investment opportunity. Staff is currently preparing the RFP.

Other Investment Studies

Staff is proposing the research of additional investments such as industrial, commercial, office facilities, and multi-residential. The study will include research of secondary market sources to determine the present status and future trends of demographics and economic conditions related to each of these investment categories.

GEOHERMAL, MINERAL, AND OIL AND GAS PROGRAMS

The objectives of these programs are to manage the development of geothermal, mineral, and oil and gas resources on school lands, to maximize royalty revenue, protect the environment, and assure public safety. All monies generated from these programs benefit STRS.

FISCAL YEAR 2000-01 ACTIVITIES

GEOHERMAL PROGRAM

Geothermal Program at The Geysers

There are 5,563 acres of school lands under lease at The Geysers geothermal steam field in Sonoma and Lake counties. The Geysers is the world's largest geothermal development, currently generating about 1,000 megawatts of electricity. About 25% of the power is derived from State leased lands. The balance is derived from federal or privately owned lands. Calpine Corporation, the country's largest independent power company, owns and operates most of the steam field and power generating facilities at The Geysers. Calpine is the lessee of all eight of the State's active geothermal leases.

Royalty revenue totaled \$7,357,727.83, resulting in a \$3,430,761.74 increase over the revenues collected in FY 1999-00. The increase was due to drastically higher market prices for electrical power. Beginning in 1999, the majority of royalties paid for the use of the State's steam are based directly on the value of electricity generated from that steam. A lesser portion is based on a fixed price for steam.

In 1999, the Central California Power Agency (CCPA) had surrendered four State leases totaling 1,449 acres. Upon CCPA's surrender of the lease, the lease terms required that all wells be properly abandoned and that the surface be restored. During FY 2000-01, CCPA successfully plugged and abandoned the seven wells within these leases. The surface restoration work is not yet complete. After CCPA fulfills this obligation, the CSLC can formally accept the surrendered leases and staff can evaluate options to re-lease the parcels.

Staff began processing an application for a negotiated lease with Calpine on a 743-acre parcel of school lands at The Geysers. The parcel was under lease to another company in the early 1980's, but was quitclaimed before being explored or developed. Calpine would like to develop the parcel and utilize its steam at one of its existing power plants.

The City of Santa Rosa made significant progress on the construction of the Santa Rosa Geysers Recharge Project (SRGRP); a 41-mile pipeline used to transport treated wastewater from Santa Rosa to The Geysers for injection. The

pipeline is expected to be in operation in late 2002. Calpine began construction of a system of smaller pipelines to distribute the SRGRP water throughout The Geysers. Staff continued to work with Calpine concerning the optimal utilization of this injection water.

Geothermal Prospecting Permit Applications

Staff received and began processing applications from two companies for geothermal prospecting permits involving school lands parcels in the vicinity of Truckhaven near the western shore of the Salton Sea in Imperial County. The State's parcels are interspersed with both private and federal parcels, some of which are currently held by ORMAT, Inc., a company with extensive experience in geothermal power development.

MINERAL PROGRAM

Royalty revenue totaled \$192,484.28, a 29% increase from the prior year. There are seven mineral extraction leases and two 1/16th reserved mineral agreements active. No active mineral prospecting permits exist although, two permit applications, three lease applications, and one lease amendment, extension, and assignment are pending.

Mineral Prospecting

Interest in mineral prospecting remained low due to depressed precious and base metal prices and the reduction of lands available for exploration. The CDPA and other federal land management policies have significantly reduced the availability of areas open for exploration and development.

Although mineral prospecting Permit No. PRC 8039.2 expired on June 30, 2001, Newmont Gold Company drilled approximately 150 exploratory holes during the three years it held the permit. Newmont also filed an application for a preferential lease to develop a portion of the 657-acre property as part of an expansion of the Mesquite Gold Mine. The Imperial County Planning Department and the BLM are preparing a joint Environmental Impact Report/Environmental Impact Statement for the project. Though the Mesquite Gold Mine has depleted its current gold ore reserves and idled production, upon project approval by the county and BLM, and stabilization of gold prices at \$300 per ounce or greater, the Mesquite Gold Mine should reopen and expand to include a portion of this school lands parcel.

Two mineral prospecting permit applications remain incomplete with Glamis Imperial Gold Corporation. The applications involve two school lands parcels in eastern Imperial County adjacent to the proposed Glamis Imperial Gold Mine. The applications have not moved forward due to delays involving development of adjacent BLM lands critical to the economic success of the project.

Mineral Lease Management

A mineral trespass was successfully resolved involving the Sigma Stone Black Angel Mine in San Bernardino County. This mine had started producing aggregate on a school lands parcel where the operator owns the surface and the State owns the minerals. Following lengthy negotiations with the mine owner, a negotiated mineral extraction lease was issued by the CSLC on January 1, 2001. In addition to receiving a minimum of \$0.30 per ton for all rock, sand and gravel produced in the future, the CSLC is receiving a settlement paid in 12 monthly installments totaling \$63,448.65, without interest.

Staff has been working with San Bernardino County and Caltrans to alleviate an aggregate shortage in the county resulting in high costs for both county and State road maintenance contracts. The CSLC was successful in issuing a mineral extraction lease to Washington Group International (WGI) effective March 1, 2001, for a 13-acre parcel east of Barstow along Interstate 40. WGI was the successful bidder on a large Caltrans project for the resurfacing of a portion of Interstate 40 between Ludlow and Needles. The State is receiving \$0.45 per ton for all rock, sand and gravel removed from the property. Due to a problem in obtaining a right of way agreement from the BLM, production was delayed until after the conclusion of FY 2000-01.

Another leasing success was the issuance of mineral extraction Lease No. PRC 8322.2 on May 1, 2001, for 10 acres in San Bernardino County near the Nevada border. The lease was issued to Protech Minerals, Inc., for the mining of talc minerals. Protech is the operator of several talc mines in the Kingston Mountains and also owns and operates a talc processing facility in Victorville. Much of the talc it sells is used in ceramics. Due to equipment failure, mining on the State lease did not commence during FY 2000-01. A royalty of \$4.40 per ton will be paid on all talc removed from the school lands parcel.

The extraction of sand and gravel continues on mineral extraction Lease No. PRC 7301.2 by Hanson Minerals in San Diego County. Staff received and began processing an application by Hanson to extend, amend and assign the lease from its predecessor, Nelson and Sloan Company. The minimum royalty of \$0.25 per ton will be increased and a reconciliation performed on prior lease production. This lease contributed in excess of \$80,000 in royalties for FY 2000-01.

Mineral extraction Lease Application No. PRC 6735 with the federal Bureau of Reclamation remained incomplete. Staff has been working with the Bureau of Reclamation, San Bernardino County and the State Office of Mine Reclamation to resolve financial assurance issues prior to the lease moving forward. The application involves the quarrying of about 20 million tons of rip-rap armor rock over a thirty year lease period north of Needles. The rock will be used to

stabilize the banks of the Colorado River for the protection of life and property during high water levels.

An application for a negotiated mineral extraction lease was received from Hi-Grade Materials in San Bernardino County for the enlargement of an existing sand and gravel mine north of Big Bear. The proposed project will involve approximately 18 acres of school lands.

Mineral Evaluations for the California Desert Protection Act

With the hiring of an Associate Mineral Resources Engineer on August 1, 2000, work accelerated on mineral evaluations necessary for the CDPA exchange program. Approximately 130 mineral evaluations were completed, with about 60% released for low mineral potential. Field exams were performed on about 15 school lands parcels in San Bernardino and Inyo counties assessed for their moderate mineral potential. These field exams included limited geologic mapping and sampling for assay. Many of these field exams and subsequent chemical assays have revealed the presence of mineral resources. Further work will likely be necessary for quantification and valuation of these mineral resources to ensure appropriate compensation is received by the State in the acquisition of federal lands in exchange.

OIL AND GAS PROGRAM

Revenues for the two existing oil and gas agreements increased to \$177,613.15, up substantially from the \$107,631.70 received the prior year. The increase resulted mostly from higher oil and gas prices.

Approximately 99% of the revenue is derived from Lease No. VA 5310.2, the 160-acre school lands parcel located in the Round Mountain oil field in Kern County. Unitization of this lease into the 2,363-acre main field area has proven highly favorable to the State. MacPherson Oil Company is the current operator. Lease No. LA 9252.2, a seven-acre school lands parcel located in the Sulfur Crest area of the Santa Paula oil field in Ventura County, produced the balance of the revenue, approximately \$1,800.

**SUMMARY OF REVENUE GENERATED FROM GEOTHERMAL, MINERAL,
AND OIL & GAS PROGRAMS: FISCAL YEAR 2000-01**

STRS FUND

Geothermal Royalties and Net Profits:

Royalties from Calpine subsidiary (GPC) leases: Lease Nos. PRC 4596.2, 4597.2, 6422.2, 6423.2	\$ 5,939,645.03
Royalties from Calpine Corp. leases: Lease Nos. PRC 5206.2, 7810.2	\$ 336,250.00
Net Profits from Calpine Corp. lease: Lease No. PRC 5206.2	\$ 810,306.28
Royalties from Calpine subsidiary (Silverado) lease: Lease No. PRC 7845.2	\$ 271,526.52
Geothermal Total:	\$ 7,357,727.83

Mineral Royalties and Rent:

Total from seven leases and two agreements in Imperial, Inyo, Napa, Riverside, San Bernardino, San Diego and Yolo Counties:	\$ 192,484.28
--	----------------------

Oil and Gas Royalties:

Total from two leases, one in Kern County, and one in Ventura County:	\$ 177,613.15
---	----------------------

TOTAL GROSS REVENUE GENERATED TO STRS FUND: \$ 7,727,825.26

FISCAL YEAR 2001-02 PLANNED ACTIVITIES

GEOHERMAL PROGRAM

Geothermal Program at The Geysers

Staff estimates the State's royalty revenue from its school lands geothermal leases at The Geysers will reach \$4 million in FY 2001-02. This is lower than in FY 2000-01 because market prices for electricity are not expected to reach the same extreme levels. To maximize the State's future royalty revenue, staff plans to continue working with Calpine on the following goals: (1) to develop State acreage already under lease but not fully developed; (2) to negotiate terms for re-leasing acreage quitclaimed by CCPA and adjacent unleased State acreage; (3) to improve the utilization of available steam resources through optimization of steam field and power plant operations; (4) to facilitate the construction of a distribution system for SRGRP injection water; and (5) to select well conversion candidates for optimal injection benefits. Finally, staff plans to continue its on-going efforts to monitor all production operations and engineering projects on State leases and adjacent lands, verify all pricing and royalty calculations, and seeking opportunities to increase royalty revenue from school lands at The Geysers geothermal field.

Geothermal Prospecting Permit Applications

Given the apparent competitive interest in leasing school lands parcels on the west side of the Salton Sea near Truckhaven, staff plans to consider the possibility of conducting a competitive bid lease sale rather than issuing prospecting permits. Staff believes ORMAT, Inc., will likely nominate the State's parcels for a competitive lease sale. However, before conducting such a lease sale, an analysis of potential impacts of geothermal exploration and development will have to be undertaken pursuant to the requirements of the California Environmental Quality Act (CEQA). The company nominating the lands will likely advance the costs for such analysis, though the successful bidder would ultimately bear those costs. Another consideration associated with leasing the school lands parcels is that the California Department of Parks and Recreation (DPR) owns and utilizes much of the surface lands in this area as part of its Ocotillo Wells State Vehicular Recreation Area. Staff plans to work with the DPR, and the Imperial County Planning Department, to assure that proposed geothermal development does not interfere with the use of the area for off-road recreation.

MINERAL PROGRAM

Mineral Prospecting

Based on the BLM's reversal of its earlier decision to deny the Glamis Imperial Gold project, staff anticipates that Glamis Gold will move forward with the development of its open pit gold mine involving federal lands. Upon such development, staff plans to complete the processing of applications to prospect nearby school lands parcels to determine if the resource extends onto State property. Staff anticipates the CSLC may consider the issuance of these prospecting permits in the fourth quarter of FY 2001-02.

Mineral Lease Management

Royalty revenue from mineral leasing is expected to increase by at least 10% during FY 2001-02 as those mineral leases issued in the second half of FY 2000-01 ramp up to full production and as other leases are issued and amended.

Staff anticipates the approval by the CSLC of an amendment to mineral extraction Lease No. PRC 8272 to increase the mine area to 64 acres and increase the lease term to ten years. This will provide WGI the necessary rock, sand and gravel required for road construction and maintenance activities in the nearby area. Staff anticipates revenue from this lease on the order of \$100,000 per year.

It is anticipated that staff will approve a preferential mineral extraction lease to Newmont Gold Company for lands acquired as part of the CDPA exchange and located adjacent to the Mesquite Gold Mine. Anticipated royalties are estimated to be \$50,000 per year for a five-year period beginning FY 2002-03.

Staff will work on the approval of an amendment, extension, and assignment of Lease No. PRC 7301 with Hanson Minerals in San Diego County. The amendment should provide for increased revenue on the order of \$100,000 per year as a result of a higher royalty rate.

Staff will continue its processing of an application for a negotiated mineral extraction lease with Hi-Grade Materials in San Bernardino County. Staff expects consideration of the lease by the CSLC during the latter part of FY 2001-02. Royalties are not anticipated until FY 2002-03. Over the life of the project, total royalties from the 18 acres should be on the order of \$250,000.

Efforts to resolve issues hindering the reissuance of mineral extraction Lease No. PRC 6735 to the Bureau of Reclamation for the excavation of riprap rock to armor the levees of the Colorado River are planned to continue. Staff will continue work with the Bureau of Reclamation, the San Bernardino County

Planning Department and the State Office of Mine Reclamation. However, due to certain complexities, resolution is not expected during FY 2001-02. Potential revenues over the life of the lease could exceed \$10 million.

Negotiations will continue between CSLC staff and Kaiser Steel Corporation, lessee of mineral extraction Lease No. PRC 5678, to exchange approximately 440 acres of reserved mineral interest lands for another mineral estate of equal or greater value. The existing property is within the confines of a large open pit that was mined for iron ore over many decades. Kaiser has permitted a landfill at the site and plans to sell the property to the Los Angeles County Sanitation District. Since future iron ore mining is unlikely, staff will attempt to obtain other mineral property with higher mineral development potential.

Staff plans to process an application to modify the right of surface entry on a three-acre parcel of reserved mineral interest school lands in San Francisco. The parcel is part of a large redevelopment plan. A registered geologist will be consulted to determine whether any valuable minerals exist on the property. Staff anticipates the CSLC will ultimately approve the modification during FY 2001-02.

Mineral Evaluations for the California Desert Protection Act

All 440 fee-owned school lands parcels have been assessed for mineral potential. Of these, 263 have been released for sale at the appraised value of the surface. The remaining parcels have moderate or high mineral potential and need further analysis prior to valuation. Staff plans to continue the field work that commenced during FY 2000-01, and to continue a series of meetings with the BLM relative to these remaining parcels. Staff also anticipates the amendment of two Memoranda of Agreements (MOA) with the BLM. The BLM would like to renegotiate the exchange involving 44 BLM tracts with oil and gas potential. The CSLC would like to amend the MOA involving valuation of minerals on school lands parcels to be consistent with the State Surface Mining and Reclamation Act.

OIL AND GAS PROGRAM

Revenues from the two school lands oil and gas leases are anticipated to total approximately \$100,000 during FY 2001-02. This is somewhat lower than the prior year due to an anticipated reduction in oil and gas prices.

FINANCIAL SUMMARY: FISCAL YEAR 2000-01

STRS FUND

REVENUES AND EXPENSES

Revenues:

Surface Rentals	\$	175,651.61
Interest Income from Investments		313,251.35
Additional Receipts		21,216.86
Geothermal		7,357,727.83
Minerals		192,484.28
Oil and Gas		177,613.15
TOTAL	\$	8,237,945.08

Less: Geothermal Resource Development Account (GRDA) Deposits (Public Resources Code Section 3826)		<181,527.56>
--	--	--------------

TOTAL \$ 8,056,417.52

Expenses: Net Management Costs

Land Management	\$	438,194.67
Geothermal		294,162.86
Minerals		526,998.48
Oil and Gas		24,816.95
Ownership Determination		66,228.96
TOTAL	\$	1,350,401.92

Less: Reimbursement Recovery		<51,170.54>
--	--	-------------

TOTAL \$ 1,299,231.38

NET REVENUES TO STRS \$ 6,757,186.14

SCHOOL LAND BANK FUND

Balance as of July 1, 2000	\$	34,806,765.95
SMIF Interest Earned Fiscal Year 2000-01		2,160,115.43
Revenue From Land Sales		146,998.50
Less: Down Payment Barstow Acquisition; DGS Contract . . .		<33,710.00>

BALANCE OF SLBF AS OF JUNE 30, 2001 \$37,080,169.88