

CALIFORNIA STATE LANDS COMMISSION

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

Fiscal Year 2001-02

CALIFORNIA STATE LANDS COMMISSION

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Submitted to
the Governor, the California State Legislature,
and the State Teachers' Retirement System

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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. 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 statutory trust in 1984 when the State Legislature approved the School Land Bank Act (Act), created the School Land Bank Fund (SLBF), and designated the CSLC as trustee of this fund. The Act added Sections 8700 through 8716 to the Public Resources Code (PRC), which set forth the management guidelines for the Program and 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 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). With the CSLC serving as trustee for the SLBF, a fiduciary relationship exists between the CSLC (trustee) and STRS (beneficiary), and obligates the CSLC to make school lands productive, primarily in financial terms, for the beneficiaries of STRS. This fiduciary responsibility includes protection of trust assets as well as the generation of revenue.

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) 2001-02 were \$1,580,370.34. Net revenue transferred to STRS was \$3,375,547.76. Net revenue deposited to the SLBF was \$5,920,864.29, resulting in a fiscal year end

balance of \$43,001,034.17. For a summary, see the table entitled "Financial Summary: Fiscal Year 2001-02" (page 28).

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 2001-02 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. These activities include land exchanges and land sales of school lands parcels to public and private entities; acquisitions of lands to enhance the resource base; issuance of leases for various purposes such as agricultural, grazing, and rights of way for roads, oil and gas pipelines, and transmission lines. Activities also include the management of approximately 37,000 acres of commercially harvestable 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 a summary of the revenues generated to STRS and the SLBF through this program, see the table entitled "Summary of Revenue Generated From Surface Management Program: Fiscal Year 2001-02" (page 10).

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. 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 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.

To date, there have been four 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 SLBF. In June 1997 a second transaction resulted in \$144,000 being deposited into the SLBF 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 school lands acres 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 SLBF, 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 SLBF 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 were acquired with the intent of potentially generating revenue to STRS through gold mining activities. The CSLC has not yet transferred the value of these lands to the BLM.

A fifth CDPA land exchange involving the CSLC, BLM, and Metropolitan Water District of Southern California (MWD) is near completion. Upon the close of escrow, 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 project referred to as the Downey transaction. It is anticipated that the CDPA program will receive a credit of approximately \$2 million from the transfer of a federal surplus property in Downey. Upon the transfer to the BLM of an equal amount of school lands, the proceeds from the exchange will be deposited into the SLBF.

At this time, prior to the completion of the Downey land transaction, there are approximately 185,000 acres of school lands valued at nearly \$28 million remaining within the designated national parks, monuments, preserves, and wilderness areas available to exchange with the BLM.

FISCAL YEAR 2001-02 ACTIVITIES

STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Total revenue deposited into the STRS Fund from surface management activities in FY 2001-02 was \$487,936.94. This money was generated from the following transactions:

Surface Rental Income

Although many of the 478,000 acres of school lands are isolated, landlocked parcels with the majority being non-productive desert lands, close to a quarter of the acreage is leased for revenue generating purposes. Rent received from approximately 140 revenue-generating leases totaled \$271,586.21. 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.

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 carried promissory notes secured by deeds of trusts for each of the two cities. Interest on the City of Shasta Lake's note for FY 2001-02 totaled \$29,804.08. The city of Pomona's final interest payment totaled \$186,546.65 before its note was paid off in December 2001. The total revenue received from the interest payments was \$216,350.73.

SCHOOL LAND BANK FUND REVENUES

Principal revenue from three school lands transactions totaled \$4,639,051.20. The total accrued interest earned on the SLBF was \$1,341,078.09. A total of \$5,920,864.29 in net revenue was generated to the SLBF during FY 2001-02.

City of Shasta Lake Land Sale (SA 5752)

The City of Shasta Lake made two principal reduction payments totaling \$38,187.20 on its loan from CSLC for the purchase of a school lands parcel in FY 1999-00.

CDPA/City of Pomona Land Sale (AD 280)

In November 1997, the CSLC acquired a 100-acre federal surplus property in Pomona in exchange for transferring title of 57,309 acres to the federal government as part of the CDPA land exchange project. The CSLC immediately sold the 100-acre parcel to the city of Pomona for \$13,155,120.00. The terms of the sale included the CSLC carrying a note in the amount of \$7,258,490.00 for 7 years at 7%. The City paid off the note early with its final payment in the amount of \$4,525,142.00 being submitted to the CSLC in December 2001. The CSLC issued a partial reconveyance to release the deed of trust.

West Patton Village Community Services Land Sale (SA 5749)

Staff completed 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.

Miscellaneous Receipts

Two patent payments in the amount of \$361.00 each were deposited into the SLBF account for patents issued in December 1999 (Delaney) and February 2000 (Beasley), respectively. The miscellaneous receipts totaled \$722.00.

Accrued Interest on the SLBF

The total accrued interest earned on the SLBF during FY 2001-02 was \$1,341,078.09. Accrued interest earnings declined from the previous year due to the lower interest rates that resulted from the general downturn in economic conditions.

SCHOOL LAND BANK FUND INVESTMENTS AND OTHER ACTIVITIES

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

Agricultural Property Investment (W 25759)

On July 5, 2001, pursuant to Commission authorization received in April 2001, CSLC staff awarded a contract to Agland Investment Services, Inc. for completion of a study on the feasibility of acquiring agricultural property as an investment option for SLBF monies. The consultant's final report, entitled "Planning for Agricultural Land Investments in California", was completed September 28, 2001. Based on the report, staff concluded that agricultural properties meeting criteria outlined in the report would be suitable for investment of SLBF monies. Utilizing the investment criteria contained in the consultant's report, CSLC staff developed a notice seeking agricultural property investments in California. The notice was mailed to members of the agricultural community, and advertisements were placed in several California newspapers. In addition, the notice was posted on the CSLC website. Numerous responses and property submittals were received by the closing date of the notice on March 30, 2002. Staff proceeded to analyze the property submittals received and complete additional research throughout California on agricultural market conditions and the feasibility of investment of SLBF monies. For further details on the progress of investment in agricultural property, see the discussion under "Fiscal Year 2002-03 Planned Activities, Potential School Land Bank Fund Investments - Agricultural Property" (page 15).

Barstow Property Development (W 25758)

On September 28, 2001, pursuant to Commission authorization received in April 2001, CSLC staff circulated a Request for Proposal (RFP) to locate a consultant to study the feasibility of ground leasing an approximately 34-acre school lands property located at the northwesterly corner of Avenue L and Interstate Highway 15 in Barstow. A contract to complete the study was awarded to the firm Wallace and Steichen, Inc. on December 3, 2001. The consultant's final report, entitled "Feasibility Study for NWC Interstate 15 at Avenue L, Barstow, CA" was completed March 20, 2002. The report was very positive as to the prospects for a successful ground-leasing program for the property, and several development options were presented. Due to the large property size and the nearly twenty year forecast absorption period, it was determined that the best option was for the CSLC to act as master developer of the property (design an overall site plan,

construct infrastructure improvements and lease individual pad sites). Based on the consultant's report, staff concluded that professional planning services to help develop an overall conceptual site design was the next step required for development of the property. In April 2002, the Commission authorized staff to retain such planning services. In February 2002, staff had contracted with a firm to complete a Phase I environmental assessment of the property. Initial drafts of the report indicate there are no significant environmental conditions present that would adversely impact development of the site. For further details on the progress of the Barstow property development, see the discussion under Fiscal Year 2002-03 Planned Activities, Potential School Land Bank Fund Investments-Barstow Property Development.

Ground Leasing Investment Feasibility Study (W 25774)

On March 25, 2002, pursuant to Commission authorization received in September 2001, staff awarded a contract to Wallace and Steichen, Inc. for completion of a study on the ground leasing market in California and to assist staff in determining whether ground leased property, or property suitable for ground leasing, would be an appropriate investment vehicle for SLBF monies. A first draft of the report is scheduled to be completed in July 2002. For further details on the progress of the Ground Lease report, see the discussion under Fiscal Year 2002-2003 Planned Activities, Potential School Land Bank Fund Investments-Ground Leasing Investment Feasibility Study.

North Coast Resource Center Investment

Staff is considering participating in the development of a proposed State office building along the northern California coast of Humboldt County (Eureka vicinity), 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 (either purchasing or constructing a building). The building would enable the Resources Agency to consolidate various offices scattered throughout the Eureka/Arcata area. In April 2002, staff was authorized by the Commission to pay the Department of General Services \$30,000 to prepare a feasibility study. The feasibility study is nearing completion and should address the initial space needs of participating agencies, estimate the cost of acquiring or constructing a facility of adequate size for the potential occupants, estimate the continual maintenance costs, and the rental rate required to produce a market rate of return on the investment. Upon completion of the feasibility study, an analysis of the local office rental market will be needed in order to decide whether to proceed with the proposal.

Other Investment Studies

Staff has researched numerous current listings of additional property types, including 87 agricultural properties, 27 industrial properties, and 28 commercial properties. In addition, secondary market sources were researched to determine the present status and future trends of demographics and economic conditions related to each of these investment categories. The study concluded that the most promising property types for investment of SBLF monies, considering the size of the fund and the legislative mandate that investments are to be resource based, consisted of agricultural property and perhaps ground leased property. Research indicated that both property types offer competitive, long-term predictable cash flows, potential for appreciation, are less management intensive and provide the opportunity for broader diversification of the asset base in terms of location. In addition, California agriculture provides the opportunity to invest in one of the most diversified and productive farm economies in the world. Also, agricultural properties participate in global markets and are not as subject to downturns in local and regional markets as are other investment grade properties. For additional information, please see "Fiscal Year 2002-03 Planned Activities, Agricultural Property Investment Report" (page 15).

SUMMARY OF REVENUE GENERATED FROM SURFACE MANAGEMENT PROGRAM: FISCAL YEAR 2001-02

STRS FUND

Surface Rentals:

Surface Rentals: \$ 271,586.21

Total: \$ 271,586.21

Interest Income from Investments:

(Interest earned on notes held on land sale transactions)

City of Shasta Lake (SA 5752): \$ 29,804.08

City of Pomona (AD 280) \$ 186,546.65

Total: \$ 216,350.73

TOTAL GROSS REVENUE GENERATED TO STRS FUND: \$ 487,936.94

SCHOOL LAND BANK FUND

Land Sales:

City of Shasta Lake (SA 5752)
Principal Reduction Payment
Revenue Generated: \$ 38,187.20

City of Pomona (Ad 280)
Principal Reduction Payment
Revenue Generated: \$ 4,525,142.00

West Patton Village Land Sale (SA 5749)
Revenue Generated: \$ 75,000.00

Miscellaneous Receipts for patents \$ 722.00

Total: \$ 4,639,051.20

Accrued Interest on the School Land Bank Fund: \$ 1,341,078.09

**TOTAL GROSS REVENUE GENERATED TO SCHOOL
LAND BANK FUND: \$ 5,980,129.29**

FISCAL YEAR 2002-03 PLANNED ACTIVITIES

POTENTIAL STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Surface Rentals Income

Staff will continue to receive income from the leased 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.

Income from Timber Harvests

In June 2001, the "Covelo Fire" (W 25782) burned portions of two school lands parcels totaling 160 acres in the Covelo area of Mendocino County. Staff will work on securing access to the burned areas and contracting for the services of a Registered Professional Forester to prepare and submit a Notice of Emergency Timber Operations. Upon the completion of this plan, staff will contract for the sale and removal of the fire damaged timber. Net proceeds from the timber sale, estimated to be in the range of \$20,000, will be credited to STRS.

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

Staff will continue to receive requests for land exchanges and land sales throughout the year. The following are exchange and sale projects that the CSLC has received applications on and has initiated steps to consider the requests.

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 2002-03:

Metropolitan Water District (W 24480/AD 384)

Staff will complete a three-party land exchange between the CSLC, BLM and MWD. The CSLC is prepared to 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 close of escrow, \$456,900 will be deposited into the SLBF.

Bureau of Land Management (W 24480/AD 407)

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. Currently, the CSLC owes the BLM \$2,154,675. On November 9, 2001, the BLM requested that the CSLC transfer school lands equal in value to this amount owed to the federal government in order to eliminate the outstanding balance. Staff will work with the BLM to transfer approximately 8,000 acres to the federal government upon BLM's notification that it is ready to proceed. Although this individual transaction is not revenue generating, it is an activity processed pursuant to the CDPA and the SLBF.

Downey/CDPA Lands Transaction (W 24480/AD 385)

Negotiations continue on the Downey/CDPA Lands Transaction. The original proposal included the CSLC participating in a five-party land exchange involving the BLM, General Services Administration (GSA), National Aeronautics Space Administration (NASA), CSLC, and the City of Downey. The CSLC would take title to approximately 96 acres of federal 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.

Discussions are underway to modify the transaction to have GSA sell the surplus lands directly to the City, thereby eliminating the CSLC from taking title to the property, selling it to the City, and carrying a note. The CDPA program will still benefit from the GSA's sale of the property by having the net proceeds being credited to the SLBF upon the CSLC's transfer of the equivalent value of school lands to the federal government. Staff will continue to work with the involved parties on consummating this transaction.

44+ Parcel Exchange (W 24480 & W 40157.3)

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.

Amargosa Canyon Land Exchange (W 25843)

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. For consideration, the CSLC will receive cash for the fair market value of the school lands parcel (\$256,000) from the private party as part of the exchange transaction. As a result of the exchange, 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; and the NPS will receive title to the private party's property within Death Valley National Park. The CLSC is waiting for the BLM to complete its Feasibility Study of the exchange. Upon BLM's request, the CSLC staff will continue negotiations with the BLM, NPS, and private party on this transaction.

Town of Apple Valley Land Sale (SA 5754)

Staff will complete 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. The sale will net \$ 241,102 to the SLBF.

San Bernardino County Land Sale (SA 5756)

Staff will complete a land sale to the San Bernardino County Public Works Department that will result in a 1.27-acre school lands parcel being transferred to the County. The parcel is needed for a road improvement project. A total of \$900 will be deposited into the SLBF upon issuance of the patent.

Dyer Mountain Land Sale (W 25718)

Staff will continue negotiations to 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. This sale will result in an estimated \$3 million deposit into the SLBF. Staff plans to enter into a purchase agreement with the proponent by the middle of the fiscal year.

Metropolitan Water District Land Sale (SA 5755)

Metropolitan Water District of Southern California (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 Project to store water from the Colorado River. The school lands parcel will act as a buffer to prevent contaminated groundwater from getting into the groundwater basin project area from the north. Staff will continue efforts to consummate this sale, which is valued at \$60,000.

Caltrans Land Sale for Route 247 Road Improvement (SA 5757)

Staff continues to work with the California Department of Transportation (Caltrans) who made application to acquire the underlying fee of 7.15 acres of school lands in the Lucerne Valley. The area is necessary for State Highway Route 247 road improvement purposes. The sale will generate approximately \$5,700.00 to be deposited into the SLBF.

United States Forest Service Land Exchange (W 23390)

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 inholdings and benefits both agencies. Phase 1 of the exchange, which included CSLC inholdings primarily in southern California, was completed in 1990. Phase 2 of the Exchange was delayed due to required federal cultural and archaeological studies. In Phase 2, the CSLC would exchange its remaining national forest inholdings 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 areas of investment of SLBF monies are continuing to be explored in addition to the ongoing consideration of financing a proposed State office building near Eureka (North Coast Resource Center). The activities involve agricultural property investments, ground leasing a parcel in Barstow, San Bernardino County, and other ground leasing possibilities throughout California. Other investment alternatives will continue to be considered as possible investment avenues for SLBF monies.

Agricultural Property Investment Report

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. The author of the report has been retained on a contract extension basis and will be available to provide professional industry expertise and analysis of those agricultural properties deemed by staff to be acceptable investments for SLBF monies. Staff anticipates an initial investment of \$1 million to \$5 million in California agricultural land during FY 2002-03.

Barstow Property Development

In conjunction with development of the Barstow property, a request for a survey will be submitted to CSLC Boundary Services. Completion of the Phase I environmental site assessment of the property is anticipated in the first quarter.

Ground Leasing Investment Feasibility Study

Staff anticipates receiving the consultant's draft report in October 2002. The report will be utilized by staff to determine the feasibility of ground-leased property, or property suitable for ground leasing, as a potential alternative investment vehicle for SLBF monies. If the report indicates there are positive prospects for this type of investment, staff proposes to continue pursuing of investment of SLBF funds into long-term ground leases. Staff would research specific 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.

North Coast Resource Center Investment

Staff expects to receive the completed North Coast Resource Center Feasibility Report from the DGS's, Real Estate Services Division, by mid-FY 2002-03. Depending on the findings of the report, staff may decide to contract for additional services to conduct an analysis of the local office rental market in order to consider whether to proceed with the proposal.

GEOTHERMAL, SOLID MINERAL, AND OIL & GAS PROGRAMS

The objectives of these programs are to manage the development of geothermal, solid 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. For a summary of the revenues generated to STRS through these programs, see the table entitled "Summary of Revenue Generated from Geothermal, Solid Mineral, and Oil & Gas Programs: Fiscal Year 2001-02" (page 24).

FISCAL YEAR 2001-02 ACTIVITIES

GEOTHERMAL PROGRAM

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 generation is derived from State leases, with the balance derived from federal or private lands. Calpine Corporation, through its Geysers Power Company and Silverado Geothermal Resources, Incorporated, subsidiaries, owns and operates most of the steam field and power generating facilities at The Geysers, and is the lessee of all eight of the State's active geothermal leases.

Royalty and net profit revenue from State leases at The Geysers totaled \$3,978,107.63. This is a 46% decrease from the total collected in FY 2000-01, but essentially the same as collected in FY 1999-2000. FY 2000-01 was an abnormal year because market prices for electricity were extraordinarily high throughout the State during the so-called California electrical crisis. Electrical prices returned to more normal levels in FY 2001-02. Most royalties paid for the use of the State's steam are based directly on the value of electricity generated from that steam. However, for one lease the royalties and net profits revenue are based on a fixed price for steam.

The Central California Power Agency (CCPA) successfully completed surface restoration work on four leases totaling 1,449 acres of school lands that it surrendered two years earlier. CCPA plugged and abandoned its wells and dismantled its steam field and power generating facilities after deciding that continued operation was uneconomic. After CCPA had fulfilled its restoration obligations, the CSLC, in late 2001, formally accepted the quitclaimed leases. Because the area likely still contains commercially usable steam, staff began evaluating options to re-lease the parcels.

Staff continued discussions with Calpine concerning its application for a lease on a 743-acre parcel of reserved mineral interest school lands. Calpine would develop the parcel and utilize its steam at one of its existing power generating facilities. However, because of Section 6912(a) of the Public Resources Code, staff was obligated to notify the owner of the surface estate and provide it an opportunity to submit its own application for a lease. The surface owner, WHR, Inc., exercised its option and submitted an application. Although staff began processing WHR's application, both WHR and Calpine advised that an attempt will be made to negotiate a lease between the parties so that WHR can withdraw its application and staff can proceed with Calpine's application.

The City of Santa Rosa continued to make progress on the Santa Rosa Geysers Recharge Project (SRGRP), a 41-mile pipeline to transport treated wastewater from Santa Rosa to The Geysers for injection. The pipeline is expected to be in operation in 2003. Calpine made significant progress on the construction of a system of smaller pipelines to distribute the SRGRP water throughout The Geysers. Staff continued to work with Calpine concerning the planned utilization of this injection water and approved the conversion of two older producing wells to injection.

Staff also approved a new geothermal well that Calpine drilled at The Geysers. The well penetrated both a private lease and a portion of Calpine's undeveloped State lease. The well failed to encounter steam, but Calpine remains obligated to drill into the State lease again before the end of 2003.

Geothermal Prospecting Permit Applications and Inquiries

Staff continued discussions with two companies, Mack Energy Company and Layman Energy Associates, which submitted applications for geothermal prospecting permits involving school lands parcels in the vicinity of Truckhaven, near the western shore of the Salton Sea in Imperial County. Both applications remain incomplete pending the submittal of additional project description information. Another company, ORMAT, Inc., submitted a petition for the CSLC to conduct a competitive bid lease sale in the area. That petition was later withdrawn when staff advised ORMAT that it would be required to advance funding for an analysis of potential environmental impacts of exploration and development as required by the California Environmental Quality Act (CEQA). A further consideration is that the California Department of Parks and Recreation (DPR) owns and utilizes much of the surface lands in the region as part of its Ocotillo Wells State Vehicular Recreation Area. Staff met with DPR representatives to begin discussing issues related to possible exploration and development of geothermal resources in the area to assure that such activities do not interfere with the use of the area for off-road recreation. Staff also spoke with representatives of the Imperial County Planning Department concerning its role in permitting geothermal exploration and development activities.

Staff also received an inquiry concerning the availability of a school lands parcel several miles north of the Coso Hot Springs geothermal field in Inyo County. The single 640-acre State parcel is surrounded by federal parcels, but is thought to be in an area worthy of prospecting for geothermal resources.

SOLID MINERAL PROGRAM

Royalty revenue from the solid mineral program totaled \$358,756.81, which represents an 86% increase from the total for the prior year. There are seven active State mineral extraction leases. The lessees include Hanson Aggregates, Washington Group International (WGI), Sigma Stone, Protech Minerals, U.S. Borax, Homestake Mining, and Kaiser Resources. The sizable increase in revenue is attributable mainly to rock, sand, and gravel leases held by WGI and Sigma Stone. Additionally, there are two 1/16th reserved mineral interest agreements, one with Granite Construction and one with Calspar. Although no revenue was generated from Calspar, the agreement with Granite generated \$43,170.16 in revenue. A total of 1,560 acres of school lands are involved in the above leases and 1/16th agreements. Staff began processing applications for new mineral leases with Newmont Mining, the U.S. Bureau of Reclamation (BOR), and Hi-Grade Materials, and one mineral lease amendment with Hanson Aggregates. Staff began negotiating a 1/16th mineral interest agreement with Jacobson Construction Company and began processing a new application for a mineral prospecting permit for Southern Clay Products. Two older applications for mineral prospecting permits for Glamis Imperial remain incomplete pending additional information from the applicant.

Mineral Lease Management

Hanson Aggregates (PRC 7301)

Extraction of rock, sand, and gravel continues on school lands leased to Nelson and Sloan Company, but operated by Hanson Aggregates northeast of San Diego. Royalty from this lease increased by nearly 66% to more than \$133,000 for the year, due, in part, to increased construction activity in this area. Staff continues the processing of Hanson's application to extend, amend, and transfer the lease from Nelson and Sloan Co. Numerous lease provisions are anticipated to be modified, including minimum royalty, minimum production and financial assurances.

Washington Group International (PRC 8272)

Staff worked with San Bernardino County in issuing a mineral extraction lease amendment and extension to WGI, effective December 1, 2001, for an 80-acre parcel east of Barstow near Ludlow along Interstate 40. WGI was the winning bidder on a large California Department of Transportation (Caltrans) project to resurface a portion of Interstate 40 between Ludlow

and Needles. The State received nearly \$95,000 during the year based on \$0.47 for each ton of rock, sand, and gravel removed from the lease.

Sigma Stone (PRC 8253)

Payments totaling \$66,356.68 were received during FY 2000-01 and FY 2001-02 as settlement of a mineral trespass at Sigma Stone Company's Black Angel Mine in San Bernardino County. The trespass was resolved in 2001 with the issuance of a mineral extraction lease. The payments were for the extraction of rock, sand, and gravel from the mine. Royalties during the current year totaled more than \$37,000. The mine is located between Victorville and Barstow along the rapidly-developing Interstate 15 corridor, where there is a substantial need for aggregate materials for infrastructure development.

Protech Minerals (PRC 8322)

Protech Minerals holds a ten-acre mineral extraction lease at the Pioneer Talc Mine in San Bernardino County near the Nevada border. Protech also operates the Vulcan and Omega talc mines in the Kingston Mountains, five to ten miles to the west. Protech has a talc processing facility in the City of Victorville. Much of the talc it produces is used in the manufacture of ceramics. Activity on the State lease during the year was limited to pre-development work to facilitate future production. The lease requires a minimum annual royalty payment of \$6,600, the first of which will be paid in FY 2002-03.

U.S. Borax (PRC 736)

U.S. Borax is the lessee for the Gerstley Borate Mine, an underground mine operating in eastern Inyo County since the 1920's. Due to changes in regulations of the U.S. Mine Safety and Health Administration, the mine was no longer in compliance and could not legally operate. In accordance with the Reclamation Plan approved by Inyo County, the mine openings were sealed and prior surface disturbance was reclaimed. U.S. Borax is exploring the possibility of reopening the mine, which provides a unique blend of calcium and sodium borates, with a small open pit. In the interim, U.S. Borax continues to pay a minimum annual royalty of nearly \$20,000.

Homestake Mining (PRC 7808)

Homestake continues to pay the State approximately \$4,500 per year rental on 305 acres of school lands that are part of Homestake's McLaughlin Gold Mine in Napa and Yolo Counties in northern California. To date, production of minerals on the State parcel has not occurred, and mining has ceased on the remainder of the gold mine while mine closure and reclamation are in progress.

Kaiser Resources (PRC 5678)

Kaiser approached staff on the possibility of a mineral exchange in the area of Kaiser's Eagle Mountain Iron Mine in Riverside County. The exchange would help facilitate the sale and operation of a landfill operated by the Los Angeles County Sanitation District within the previously mined-out pits. Kaiser's current mineral extraction lease with the State expires on December 31, 2002. That lease includes an annual rental of \$2,500. An additional \$4,272 was realized from the sale of stock acquired as part of a bankruptcy settlement several years ago. Preliminary discussions are continuing as to the possibility of exchanging the State's reserved mineral interest of about 440 acres for other mineral interests owned by Kaiser in the area of equal or greater value.

Mineral Lease Applications

Bureau of Reclamation (PRC 6735)

The Bureau of Reclamation (BOR) has filed a mineral lease application to resume the extraction of rip-rap rock at the Manchester Quarry in the Dead Mountains area of San Bernardino County near Laughlin, Nevada. Staff has been working with the BOR, San Bernardino County, and the State Office of Mine Reclamation (OMR) to resolve a financial assurance issue prior to further processing. The application involves BOR quarrying about 20 million tons of rip-rap over a thirty-year lease period for riverbank stabilization along the Colorado River to protect life and property during high water flows.

Hi-Grade Materials (W 40842)

An application for a negotiated mineral extraction lease was received from Hi-Grade Materials for the enlargement of an existing sand and gravel extraction operation near Hesperia in San Bernardino County. The proposed project involves about 18 acres of school lands. The County has been working with Hi-Grade to resolve several engineering issues prior to consideration of Hi-Grade's Conditional Use Permit (CUP) application. The CSLC would consider Hi-Grade's mineral lease application after the County has approved the CUP and Reclamation Plan.

Jacobson Construction (W 40783)

Staff corresponded with Jacobson Construction regarding a 1/16th mineral interest on approximately 45 acres of school lands in a 70-acre area proposed for sand and gravel extraction. The extracted material will be used to resurface portions of Interstate 15 from Baker to the Nevada border and for local construction needs. Staff is working to ensure appropriate payment for its portion of the aggregate resource.

Mineral Prospecting Permits and Applications

Interest in mineral prospecting on school lands remained limited during the year due to depressed precious and base metal prices. Federal land management policies have reduced the availability of areas open to mineral exploration and development, particularly in the desert areas of California, including the area of the CDPA.

Glamis Imperial (W 40588, W 40589)

Two mineral prospecting permit applications remain incomplete from Glamis Imperial Gold Corporation of Yuma, Arizona. The applications involve two school lands parcels in eastern Imperial County adjacent to the proposed Glamis Imperial gold mine. The applications have not progressed due to delays involving development of adjacent BLM lands, which are critical to the economic success of the project.

Southern Clay Products (W 40851)

A mineral prospecting permit application submitted by Southern Clay remains incomplete. The proposed permit area is east of Death Valley in Inyo County near the Nevada border. Valuable clay minerals are mined in the same area, and Southern Clay proposes exploration to determine if a commercially viable clay resource underlies the school lands parcel.

Newmont Mining (PRC 8039)

Staff continued processing an application filed by Newmont Mining for a preferential mineral extraction lease to develop a portion of the State's 657-acre property in Imperial County as part of an expansion of Newmont's Mesquite gold mine. Imperial County and the U.S. Bureau of Land Management (BLM) have approved a joint EIR/EIS for the project. The CSLC, as a CEQA responsible agency, will consider issuing a mineral extraction lease to Newmont during the first half of FY 2002-03. Newmont's first rental payment in the amount of \$3,285 will be due at that time.

Mineral Evaluations for the California Desert Protection Act (CDPA)

Staff used readily available technical information to review and assign mineral potential to those school lands parcels remaining after the past release of 265 parcels assessed for low mineral potential. Of these remaining parcels, 99 possess moderate potential, and 73 possess high potential. Staff is attempting to negotiate exchanges without comprehensive, time-consuming, and expensive field evaluations for similar federal mineral lands in other areas of California. This approach will both support the environmental mandate of the CDPA and should maintain or maximize the future income-generating potential of mineral lands through acquisition of market-sensitive mineral properties. Particular focus has been applied to identifying, analyzing, and marketing aggregate-bearing school lands, which could assist in meeting the ever-growing concrete and asphalt demands of road projects planned by Caltrans to maintain and expand the State's highway system. Staff began assembling a portfolio of high potential parcels for possible mineral exploration and development to maximize revenue.

OIL & GAS PROGRAM

Revenue from the two existing school lands oil & gas agreements increased to a total of \$190,736.57 for FY 2001-02, up from \$177,613.15 for the prior year. The increase was attributable to higher oil prices.

Round Mountain (VA 5310)

Approximately 99% of the oil & gas revenue, or \$190,352.40, was derived from this 160-acre school lands parcel in the Round Mountain oil field northeast of Bakersfield in Kern County. 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 produced the balance of the revenue totaling \$411.17, down from the approximately \$1,800 received last year.

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



SUMMARY OF REVENUE GENERATED FROM GEOTHERMAL, SOLID MINERAL, AND OIL & GAS PROGRAMS: FISCAL YEAR 2001-02

STRS FUND

Geothermal Royalties and Net Profits:

Royalties from leases at The Geysers:	\$ 3,199,266.52
Net Profits from lease at The Geysers:	\$ 778,841.11
Geothermal Total:	\$ 3,978,107.63

Solid Mineral Royalties and Rent:

Royalties from leases and 1/16th agreements in Imperial, Inyo, Napa, Riverside, San Bernardino, San Diego and Yolo Counties:	\$ 358,756.81
Solid Mineral Total:	\$ 358,756.81

Oil & Gas Royalties:

Total from leases in Kern and Ventura Counties:	\$ 190,763.57
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TOTAL GROSS REVENUE GENERATED TO STRS FUND: \$ 4,527,628.01

FISCAL YEAR 2002-03 PLANNED ACTIVITIES

GEOHERMAL PROGRAM

The Geysers

Staff estimates the State's royalty revenue from its school lands geothermal leases at The Geysers will reach \$3.65 million in FY 2002-03. This is slightly less than in FY 2001-02 because of a minor decline in production volumes. Prices for electrical power are expected to remain stable. Staff anticipates an additional \$720,000 in revenue from settlement of several disputes over the valuation of steam produced from State leases from 1990 through 1999.

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 generating facility operations; (4) to facilitate the completion of a system to distribute 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 look for new opportunities to increase royalty revenue from school lands at The Geysers geothermal field.

Geothermal Prospecting Permit Applications and Inquiries

Staff will continue working with its two applicants for geothermal prospecting permits, and work with the DPR and Imperial County to coordinate the permitting of exploration activities in the vicinity of Truckhaven on the west side of the Salton Sea. Staff also will process any other applications it may receive for geothermal prospecting on school lands.

SOLID MINERAL PROGRAM

Mineral Lease Management

Revenue from solid mineral leasing is expected to increase by approximately 20% during FY 2002-03. The increase will stem from recently issued leases coming to full production, the issuance of two new leases, the amendment of an existing lease, and a new 1/16th mineral agreement.

Staff anticipates approval of a preferential mineral extraction lease to Newmont Mining during FY 2002-03 for lands acquired as part of the CDPA exchange and adjacent to the existing Mesquite Gold Mine in eastern Imperial County. Approval

of a new mineral extraction lease to Hi-Grade Materials may occur in the latter portion of FY 2002-03 for the mining of sand and gravel north of the mountain town of Big Bear in San Bernardino County. Total royalties over the life of the project should be on the order of \$250,000, but none are expected until FY 2003-04.

Staff anticipates approval of the amendment, extension, and transfer of Hanson's mineral lease in San Diego County during FY 2002-03. The amendment should provide for a doubling of revenue as a result of a higher royalty rate and higher minimum annual production.

A 1/16th mineral agreement is likely to be concluded with Jacobson Construction for an aggregate project near Baker. Such an agreement is likely to provide upwards of \$50,000 per year in mineral royalty when Caltrans performs planned construction and maintenance work on nearby Interstate 15.

Staff plans to continue efforts to resolve issues related to the re-issuance of a mineral extraction lease to the BOR for the excavation of rip-rap rock in San Bernardino County. Staff will continue work with the BOR, the County, and the State OMR. However, resolution might not be possible during FY 2002-03 due to certain complexities, especially with federal budgeting allocations. Potential revenue over the life of the lease could exceed \$10 million, making it the most prominent income stream from the solid mineral program.

Staff also plans to continue negotiations with Kaiser 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 area 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 equal or higher mineral development potential.

Mineral Prospecting Permits

Staff anticipates that Glamis Gold may prevail in permitting efforts to develop a gold mine on federal mining claims they control in Imperial County. This is based on the BLM's reversal of its earlier decision to deny the Glamis Imperial Gold project. Upon such development, staff expects Glamis to complete its applications for prospecting on nearby school lands parcels to determine if the gold resource extends onto State property. Staff also looks for the consideration and approval of Southern Clay's prospecting permit application in Inyo County in the latter part of FY 2002-03.

Mineral Inquiries

Staff will continue to investigate and respond to the many inquiries it receives throughout the year concerning the availability of school lands parcels for solid mineral prospecting or leasing. Such inquiries may total fifty or more in a typical year.

Mineral Evaluations for the California Desert Protection Act (CDPA)

As previously reported, all 440 fee-owned school lands parcels have been assessed for mineral potential, and 265 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 fieldwork that commenced during FY 2001-02, and to continue a series of meetings with the BLM relative to these remaining parcels.

OIL & GAS PROGRAM

Revenue from the two school lands oil & gas leases are expected to remain at about \$200,000 during FY 2002-03. This assumes crude oil prices do not change substantially.

FINANCIAL SUMMARY: FISCAL YEAR 2001-02

STRS FUND

REVENUES AND EXPENSES

Revenues:

Surface Rentals	\$	271,586.21
Interest Income from Investments		216,350.73
Geothermal		3,978,107.63
Minerals		358,756.81
Oil and Gas		190,763.57
TOTAL	\$	5,015,564.95

Less: Geothermal Resource Development Account (GRDA) Deposits		<59,646.85>
(Public Resources Code Section 3826)		

TOTAL \$ **4,955,918.10**

Expenses: Net Management Costs

Land Management	\$	833,100.43
Geothermal		349,714.37
Minerals		516,871.62
Oil and Gas		56,652.80
Ownership Determination		64,129.68
TOTAL	\$	1,820,468.90

Less: Reimbursement Recovery		<240,098.56>
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TOTAL \$ **1,580,370.34**

NET REVENUES TO STRS \$ **3,375,547.76**

SCHOOL LAND BANK FUND

Balance as of July 1, 2001	\$37,080,169.88
SMIF Interest Earned Fiscal Year 2001-02	1,341,078.09
Revenue From Land Sales	4,639,051.20
Less: Contracts for Investment Studies	<59,265.00>

BALANCE OF SLBF AS OF JUNE 30, 2002 \$ **43,001,034.17**

LIST OF ACROYNMS

BLM	U.S. Bureau of Land Management
BOR	U.S. Bureau of Reclamation
Caltrans	California Department of Transportation
CCPA	Central California Power Agency
CDPA	California Desert Protection Act
CEQA	California Environmental Quality Act
CSLC	California State Lands Commission
CUP	Conditional Use Permit
DPR	California Department of Parks and Recreation
EIR/EIS	Environmental Impact Report/Statement
FY	Fiscal Year
GSA	General Services Administration
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
SLBF	School Lands Bank Fund
SRGRP	Santa Rosa Geysers Recharge Project
STRS	State Teachers' Retirement System
USFS	U.S. Forest Service