

CALIFORNIA STATE LANDS COMMISSION

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

Fiscal Year 2005-06

CALIFORNIA STATE LANDS COMMISSION

Cruz M. Bustamante, Lieutenant Governor
Steve Westly, State Controller
Michael C. Genest, Director of Finance

Paul D. Thayer
Executive Officer

Submitted to:

Honorable Arnold Schwarzenegger, Governor

The California State Legislature
and
The State Teachers' Retirement System

TABLE OF CONTENTS

INTRODUCTION	1
SURFACE MANAGEMENT PROGRAM.....	3
Update: California Desert Protection Act of 1994.....	3
Fiscal Year 2005-06 Activities	5
State Teachers' Retirement System Fund Revenues.....	5
Surface Rental Income and Revenues	5
School Land Bank Fund Revenues	5
City of Shasta Lake Land Sale.....	5
Barstow Home Depot Land Sale.....	5
San Diego County Water Authority Land Sale	6
Accrued Interest on the School Land Bank Fund.....	6
Table: Summary of Revenue Generated from Surface Management Program: Fiscal Year 2005-06	7
Fiscal Year 2006-07 Planned Activities	8
Potential State Teachers' Retirement System Fund Revenues	8
Surface Rentals Income	8
Income from Timber Harvests	8
Potential School Land Bank Fund Revenues and Activities	8
CDPA/Bureau of Land Management Land Exchange....	8
Mendocino County Land Exchange	9
Bureau of Indian Affairs Land Sale	9
State Parks Ocotillo Wells SVRA Expansion Land Sale	9
New Investments – Agricultural Land/Ground Leases ...	10
Potential Hazards on School Lands.....	10
GEOHERMAL, SOLID MINERALS, AND OIL AND GAS PROGRAMS.....	11
Fiscal Year 2005-06 Activities	11
Geothermal Program	11
The Geysers	11
Geothermal Prospecting Permit Applications.....	12
Solid Minerals Program	13
Mineral Lease Management	13

U.S. Borax.....	13
Hanson Aggregates	14
Western Mesquite Mines.....	14
Sigma Stone	15
Protech Minerals	15
Granite Construction Ludlow Pit.....	15
Granite Construction Palm Desert Pit	16
Jacobson Construction.....	16
Mineral Prospecting Permits	16
Southern Clay Products	16
Mineral Lease Applications	16
Granite Construction Liberty Quarry Project	16
Bureau of Reclamation.....	17
Hi-Grade Materials	17
Cima Cinders	18
Mineral Exchange Applications.....	18
Kaiser Resources.....	18
Mineral Prospecting Permit Applications	19
Abandoned Mine Reclamation Partnership	19
Oil & Gas Program	20
Reference Map for Geothermal, Solid Minerals, and Oil & Gas	21
Table: Summary of Revenue Generated from Geothermal, Solid Minerals, and Oil & Gas Programs: Fiscal Year 2005-06.....	22
Fiscal Year 2005-06 Planned Activities	23
Geothermal Program	23
The Geysers	23
Geothermal Permit and Applications	23
Solid Minerals Program	23
Mineral Lease Management	23
Mineral Lease Applications	24
Mineral Exchange Applications.....	25
Mineral Prospecting Permit Applications	25
Abandoned Mine Reclamation Partnership	25
Oil & Gas Program	25
FINANCIAL SUMMARY: Fiscal Year 2005-06	26
ABBREVIATIONS:	27

INTRODUCTION

The California State Lands Commission (CSLC), through its State School Lands Management Program (Program) manages approximately 470,000 acres of school lands held in fee ownership by the State, and the reserved mineral interests on another 790,000± acres of school lands where the surface estate has been previously sold. Management of the Program is split between two CSLC divisions, the Land Management Division (LMD) and the Mineral Resources Management Division (MRMD). The LMD is responsible for the Surface Management Program under which all surface resources on school lands, with the exception of mineral activities, are administered. The MRMD is responsible for the Geothermal, Mineral, and Oil & Gas Programs, which involve the leasing of school lands for geothermal resources development, mining activities, and oil and gas development.

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

Pursuant to PRC Section 6217.7, all net revenues, monies, and remittances from the sale of school lands are directed to be deposited into the State Treasury to the credit of the SLBF. PRC Section 6217.5 directs all net revenues derived from the use of school lands (for example, royalties, rents, and interest generated from promissory notes) be deposited into the State Treasury to the credit of the Teachers' Retirement Fund, which benefits the State Teachers' Retirement System (STRS).

The CSLC's emphasis in administering the Program has been: 1) the maximization of revenues from school lands assets, 2) the continued implementation of the California Desert Protection Act Exchange Program, and 3) protecting the corpus of the trust. Net revenue transferred to STRS during Fiscal Year 2005-06 was \$5,439,687.45, which represents an increase of 21.16% over the prior year net revenue. Management expenses for the Program in FY 2005-06 totaled \$916,939.75, which represents an 8.6% decrease from FY 2004-05 expenses. Net revenue deposited to the SLBF was \$4,754,998.00, resulting in a fiscal year end balance of \$54,446,521.03. For a summary, see the table entitled "Financial Summary: Fiscal Year 2005-06" (page 26).

The *Annual Staff Report on the Management of State School Lands* is prepared pursuant to PRC Section 6477. The major activities for each of the Program components for FY 2005-06 are described in the following pages.

SURFACE MANAGEMENT PROGRAM

The Land Management Division is responsible for the Surface Management Program, which oversees all surface activities on school lands with the exception of mineral activities. These activities include land exchanges and sales of school lands parcels to public and private entities, acquisitions of lands to enhance the resource base, and issuance of leases for various purposes such as agricultural, grazing, and rights of way for roads, oil and gas pipelines, and electrical transmission lines. The objectives of the program are to manage surface uses to generate revenue, assure ongoing viability of the resource, protect the corpus of the trust, enhance local economies, and protect the environment. These goals are accomplished through management and development techniques that maximize the economic return to STRS and the 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 2005-06" (page 7).

UPDATE: CALIFORNIA DESERT PROTECTION ACT OF 1994

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

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

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

To date, there have been five CDPA land exchange transactions completed with the BLM. These five exchanges have resulted in the transfer of over 66,000 acres of school lands to the BLM and deposits totaling over \$14.7 million into the SLBF.

During FY 2005-06, work continued on a sixth CDPA land exchange. As the fiscal year neared completion, staff received an appraisal on 107 parcels of school lands prepared by an independent appraiser for the Department of the Interior's Appraisal Services Directorate. Staff's review of the appraisal had not been completed as of the end of the fiscal year. It is not expected that the sixth CDPA land exchange will be completed until FY 2007-08.

At the close of FY 2005-06, there were 326 parcels of school lands containing a total of approximately 185,400 acres within the designated national parks, monuments, preserves, and wilderness areas available to exchange with the BLM.

FISCAL YEAR 2005-06 ACTIVITIES

STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Total revenue deposited into the STRS fund from surface management activities in FY 2005-06 was \$151,587.30. This revenue was generated from the following sources and transactions:

Surface Rental Income and Revenues

Most of the 470,000± acres of school lands are isolated, landlocked parcels, with the majority being non-productive desert lands. However, close to a quarter of the total school land acreage is leased for revenue generating purposes. Rent received during FY 2005-06 from approximately 140 revenue-generating leases totaled \$149,313.99. General surface leasing involves ongoing activities, including processing new applications, re-issuing expired leases, processing lease assignments and amendments, conducting rent reviews, terminating old leases, and conducting other surface management activities. Income from investments provided an additional \$2,273.31, which was the amount of interest collected during FY 2005-06 from the City of Shasta Lake pursuant to their purchase of a school lands parcel in FY 1999-00.

SCHOOL LAND BANK FUND REVENUES

The total accrued interest earned on the SLBF during FY 2005-06 was \$1,965,835.76. Principal proceeds from two school lands transactions (described below) totaled \$2,752,573.48. A total of \$4,760,748.00 in gross revenue was generated to the SLBF during FY 2005-06.

City of Shasta Lake Land Sale (SA 5752)

The City of Shasta Lake made two principal payments totaling \$42,338.76 on its loan from the CSLC for the purchase of a school lands parcel that occurred in FY 1999-00. This note was paid off in FY 2005-06, so no additional future revenue will be provided from this source.

Barstow Home Depot Land Sale (SA 5760)

During FY 2005-06, staff completed the sale of 13.7 acres of commercial land in Barstow to Home Depot U.S.A., Inc (Home Depot). The completion of this sale resulted in a deposit of \$1,521,156.86 into the SLBF. As part of the transaction, Home Depot also was required to construct infrastructure on the two remaining school land parcels that lie adjacent to the Home Depot site. Upon the conclusion of this project, staff will have over 19 acres of prime commercially

zoned land that will be available for long-term ground leasing. Late in FY 2005-06, staff released a Request for Proposals (RFP) for the development of each of these two parcels.

San Diego County Water Authority Land Sale (SA 5761)

Staff completed a land sale of property located within the Dos Palmas Preserve to the San Diego County Water Authority for the purpose of environmental mitigation for the All American Canal Re-lining Project. The CSLC transferred title to two school lands parcels totaling 880 acres that resulted in a deposit of \$1,231,416.62 into the SLBF. This sale marked the highest price per acre ever paid for school lands desert parcels.

Accrued Interest on the School Land Bank Fund

The total accrued interest earned on the SLBF during FY 2005-06 was \$1,965,835.76. Accrued interest earnings increased 50% from the previous year due to the higher account balance and the higher interest rates that resulted from a general upturn in economic conditions.

SUMMARY OF REVENUE GENERATED FROM SURFACE MANAGEMENT PROGRAM - FISCAL YEAR 2005-06

STRS FUND

Surface Rentals:

Surface Rentals:	\$ 149,313.99
Miscellaneous Income	\$ 2,273.31
TOTAL GROSS REVENUE GENERATED TO STRS FUND:	\$ 151,587.30

SCHOOL LAND BANK FUND

Land Sales:

City of Shasta Lake (SA 5752) Principal Reduction Payments	\$ 42,338.76
Barstow Home Depot (SA 5760)	\$ 1,521,156.86
Dos Palmas/SDCWA (SA 5761)	\$ 1,231,416.62
Total:	\$ 2,794,912.24
Accrued Interest on the School Land Bank Fund:	\$ 1,965,835.76
TOTAL GROSS REVENUE GENERATED TO SCHOOL LAND BANK FUND:	\$ 4,760,748.00

FISCAL YEAR 2006-07 PLANNED ACTIVITIES

POTENTIAL STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Surface Rentals Income

Staff will continue to receive income from existing surface use leases and new leases (when appropriate) on school lands parcels. Staff also expects to receive new revenues from the ground leasing of two parcels of school lands in Barstow. As discussed earlier in this report (See "Barstow Home Depot Land Sale", page 5) staff recently completed the sale of 13.7 acres of prime commercial land at the Intersection of I-15 and L Street in Barstow to Home Depot, U.S.A., Inc. In addition to a cash payment, the terms of the sale required Home Depot to install infrastructure improvements (curbs, gutters, sidewalks, utility service, etc.) to service the remaining two parcels that were retained by the CSLC. Upon the conclusion of this project, staff expects to have approximately 19 acres of prime commercially zoned land that will be available for long-term ground leasing. Staff expects to award the two RFPs and to finalize ground leases on these properties during FY 2006-07.

Income from Timber Harvests

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

POTENTIAL SCHOOL LAND BANK FUND REVENUES AND ACTIVITIES

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

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

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

terms of the original CDPA legislation. When completed as proposed, approximately \$6,500,000 will be generated to the SLBF from this transaction.

Mendocino County Land Exchange (W 26045)

Early in 2005, staff received an application from White Cloud Resources (Whitecloud) that proposed a land exchange involving an 80-acre parcel of school land located northeast of Covelo in Mendocino County. Under the terms of the proposed exchange, the CSLC would transfer fee title to the 80-acre parcel to Whitecloud and Whitecloud would transfer a 100-acre parcel of nearby land that borders other CSLC property to the CSLC. The CSLC would benefit from the exchange because it would consolidate the CSLC's merchantable timber holdings into a more manageable tract. If the appraised fair market value of the CSLC property exceeded the fair market value of the exchange property, the CSLC also would receive a cash payment from Whitecloud that would be deposited into the SLBF. During FY 2005-06, real estate appraisals were completed on the properties by an independent appraiser, and staff reviewed and approved the appraisal reports. Late in FY 2005-06, staff was in the process of selecting a qualified environmental firm to prepare a Phase I environment report on the property to be acquired by the CSLC. Staff expects to complete this land exchange in FY 2006-07.

Bureau of Indian Affairs – Lauer Dam Road Land Sale (SA 5762)

Staff has received an application from the Bureau of Indian Affairs (BIA) to purchase approximately 22 acres of school lands in Modoc County. The property is required as part of a complex project to replace Lauer Dam, a federally-owned dam that has been determined to be at a "high risk" for possible failure. Staff completed a survey of the project and currently is preparing an appraisal on the property. Proceeds from this sale will be deposited into the SLBF.

State Parks – Ocotillo Wells SVRA Expansion Land Sale (SA 5763)

Late in FY 2005-06, staff received an application from the California Department of Parks and Recreation (State Parks) to purchase 5,758 acres of school lands for the expansion of Ocotillo Wells State Vehicle Recreation Area (SVRA). The land consists of nine full sections in Imperial County. State Parks recently completed an acquisition involving 4,000 acres of privately-owned land for the expansion project, and the nine sections of school lands are arranged in a "checkerboard" pattern amid this recently acquired property. This sale currently is "on hold", as State Parks is awaiting the finalization of the funding for the purchase of the nine school land parcels.

New Investments – Agricultural Land and Ground Leases

During FY 2006-07, staff will continue to research potential new investments for SLBF monies. Staff will concentrate on agricultural lands and ground leases that maximize potential revenues while minimizing management expenses. Staff also will work with the STRS real estate staff to explore methods for utilizing the expertise and resources of a larger investment fund with mutual investment goals.

Potential Hazards on School Lands

Because of their remote desert locations, some of the school land parcels in Southern California were used by the U.S. military for training purposes during World War II. These military activities included artillery practice, bomber training and tank warfare using live ammunition. With the increasing occasional use of desert lands by the public for off-road vehicle activities and other recreational purposes, concerns have been raised about the potential liability to the State and the SLBF posed by possible unexploded ordnance on these lands. In July 2006, the legislature passed and the Governor signed a new budget that included authorization and funding for a new staff position for the CSLC (Item 3560-001-0001). This new position will be responsible for analyzing potential hazards on school lands, including unexploded ordnance, and developing a plan for addressing these potential issues. The plan will be delivered to the chairs of the appropriate policy committees and the fiscal committees in both houses of the legislature by January 10, 2008.

GEOTHERMAL, SOLID MINERALS, AND OIL & GAS PROGRAMS

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

FISCAL YEAR 2005-06 ACTIVITIES

GEOTHERMAL PROGRAM

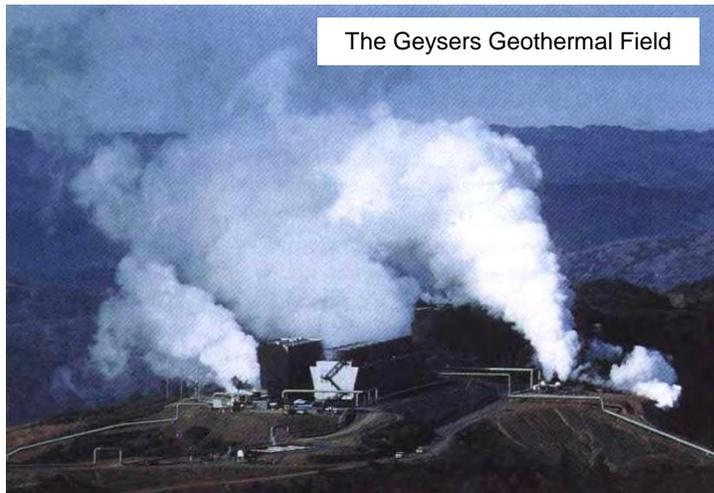
Revenue from the geothermal program totaled \$5,505,728.72 for FY 2005-06, a 10% increase from the total for FY 2004-05. All the revenue is from The Geysers geothermal field, where steam production from State leases increased by 8% for the year. The value of the steam itself increased by 6% due to higher prices for the electricity generated from that steam.

The Geysers

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

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

Geysers Power Co. LLC, a subsidiary of Calpine Corporation, owns and operates most of the steam field and generating facilities, and is the lessee of all seven of the State's geothermal leases.



The Geysers Geothermal Field

In October 2005, Geysers Power Co. submitted plans to develop portions of a 1,881-acre lease issued by the CSLC in 2004. As FY 2005-06 ended, staff was completing its review of those plans and was preparing a recommendation for the

CSLC's consideration early in FY 2006-07. Pending approval by the CSLC, Geysers Power Co. will drill several new wells on the lease over the next few years and construct new pipelines to transport steam to its existing power generating facilities.

In December 2005, Calpine Corporation and over 200 subsidiaries, including Geysers Power Co., filed for protection under Chapter 11 of the Bankruptcy Code. In May 2006, Calpine successfully filed a motion authorizing Geysers Power Co. to assume all its geothermal leases and related obligations, including the seven State leases. As a result, although the parent company Calpine Corporation and certain related subsidiaries are undergoing restructuring efforts, Geysers Power Co. has continued its geothermal operations without noticeable curtailment of steam production or electrical generation. Geysers Power Co. has fully paid all rentals and royalties due under the terms of its State leases and remains in good standing with the State.

Although no new producing wells or injectors were completed on State leases during the year, Geysers Power Co.'s efforts to enhance steam productivity and extend field life through injection of water into the geothermal reservoir has begun to reap benefits. Water for injection is obtained from condensed steam, local creeks, and from two large pipelines, one from Lake County and one from Santa Rosa. Starting in 1997 and 2003, respectively, the pipelines now carry a total of 20 million gallons of reclaimed wastewater to The Geysers each day. A system of smaller pipelines distributes water throughout The Geysers to more than 45 injection wells, twelve of which are on State leases. In 2005, for the first time in the 34-year history of the State's leases, the amount of mass injected back into the reservoir during the year exceeded the amount taken out. The increased injection may be responsible for the slight increase in production for the year. On a field-wide basis, Geysers Power Co. has seen measurable increases in steam flow rate from the injection, and increases in generation efficiency from the improvements in steam chemistry associated with the injection.



Starting in 1997 and 2003, respectively, the pipelines now carry a total of 20 million gallons of reclaimed wastewater to The Geysers each day. A system of smaller pipelines distributes water throughout The Geysers to more than 45 injection wells, twelve of which are on State leases. In 2005, for the first time in the 34-year history of the State's leases, the amount of mass injected back into the reservoir during the year exceeded the amount taken out. The increased injection may be responsible for the slight increase in production for the year. On a field-wide basis, Geysers Power Co. has seen measurable increases in steam flow rate from the injection, and increases in generation efficiency from the improvements in steam chemistry associated with the injection.

Geothermal Prospecting Permit Applications

In April 2006, the CSLC issued a geothermal prospecting permit to Deep Rose LLC on a 640-acre school lands parcel in Inyo County several miles north of the Coso geothermal field. This is the first geothermal prospecting permit issued by the CSLC since 1984. The permit gives Deep Rose an exclusive right to

prospect for geothermal resources in the permitted area for two years, subject to an extension of two additional years at the discretion of the CSLC. Deep Rose plans to drill an exploratory well that would be one of the deepest geothermal wells ever drilled in the U.S. The permit also carries with it a preferential right to a geothermal lease upon discovery of geothermal resources in commercial quantities, subject to approval by the CSLC.

Two other applications for geothermal prospecting permits remain incomplete pending submittal of viable prospecting programs and evaluation of potential environmental impacts associated with exploration. Those applications were submitted by Mack Energy Co. and Layman Energy Associates (LEA) on school lands parcels totaling 3,840 acres near Truckhaven on the western shore of the Salton Sea in Imperial County. The applicants must apply for use permits from the County's Planning Department, which would be the Lead Agency under the CEQA. Staff contacted both applicants, and each confirmed its interest in continuing to pursue these applications in the coming year.



Truckhaven, western shore of Salton Sea

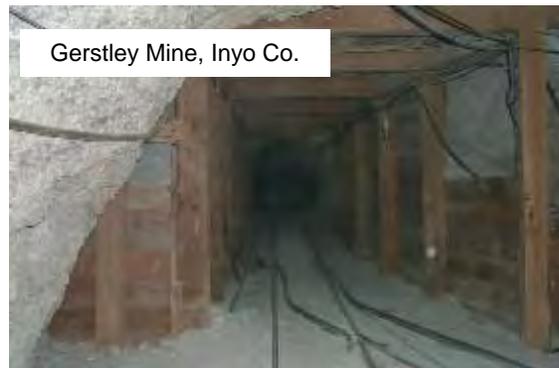
SOLID MINERALS PROGRAM

Revenue from the solid minerals program totaled \$266,561.56 for FY 2005-06, a 110% increase from the total for FY 2004-05. The increase was due mainly to resumption of production at Sigma Stone Co.'s Black Angel Quarry near the rapidly-growing community of Victorville. The solid minerals program currently manages six active mineral extraction leases totaling 1,188 acres, and one active 1/16th reserved mineral interest agreement totaling 560 acres. In addition to overseeing these mineral properties, staff continued processing applications for four new mineral extraction leases on school lands parcels.

Mineral Lease Management

U.S. Borax (PRC 736)

U.S. Borax, Inc. (USB) currently holds a 160-acre lease at the Gerstley Mine located near the town of Tecopa, southeast of Death Valley in eastern Inyo County. The mine is presently idle. USB considered acquiring permits from Inyo County and the



Gerstley Mine, Inyo Co.

CSLC for a proposed open pit mine plan, a change from its original underground extraction method. USB decided not to implement that plan. In February 2006, staff received verbal notification from USB about its intent to quitclaim the lease at the end of 2006. The State parcel at the Gerstley mine was originally leased in the 1920s. It was one of the first solid mineral leases issued by the State. USB permanently closed all the underground mine openings in 2005. Bat-compatible gates were installed at two adits, and expanded-steel grating was attached to the shaft for ventilation. This work was designed to exclude unauthorized human entry into the mine while allowing continued access by bats. USB also began surface reclamation work in 2005. That work should be complete by the end of 2006. If quitclaimed, a final inspection of the lease will be conducted by staff, as well as verification that all other lease commitments have been met. USB paid a minimum annual royalty on 600 tons of stockpile production which totaled \$20,770 for the year.

Hanson Aggregates (PRC 7301)

Hanson Aggregates (Hanson) extracts sand, gravel, and rock from a 120-acre lease located near Lakeside in San Diego County. Revenue from the lease totaled \$24,156.57 for the year.



Hanson has reduced its mining operation at the Lakeside Quarry due to a legal dispute with the State on sand leases in San Francisco Bay. The processing of Hanson's application to extend, amend, and transfer the lease from Nelson and Sloan awaits the completion of a financial audit, agreement on final lease terms and resolution of legal issues to the satisfaction of the CSLC.

Western Mesquite Mines (PRC 8039)

Western Mesquite Mines, Inc. (Western Mesquite) holds a 658-acre lease north of the Big Chief Pit in Imperial County. Most of its mine is located on BLM and private lands. In 2001, mining operations ceased due to low gold prices and depletion of resources available under existing permits. Since that time, gold prices have more than doubled to over \$600 per ounce. Staff expected Western Mesquite to resume mining operations this year, but it did not. Although Imperial County



approved a mine expansion that included the extraction of gold ore from the State lease, Western Mesquite must obtain funding to purchase shovels and haulage equipment before mining can resume.

Sigma Stone (PRC 8253)

Sigma Stone Co. (Sigma) holds a 160-acre lease at the Black Angel Quarry located in a remote site southwest of Barstow in San Bernardino County. The mine produces gravel which is primarily sold as road-base, an essential raw material for road construction. Sigma resumed mining operations in 2005. Revenue from the lease increased significantly for the year to \$109,442.57. This reflects an increase in production from higher demand by the construction industry and a booming real estate market.



Black Angel Quarry, San Bernardino Co.

Protech Minerals (PRC 8322)

Protech Minerals, Inc. (Protech) leases ten acres at the Pioneer Talc Mine in San Bernardino County. The mine is located in the Kingston Mountain Range near the Nevada border. In April 2006, the CSLC renewed Protech's lease for a second five-year term. However, the mine remained idle. Protech is awaiting more favorable market conditions before reactivating operations. At present, much of the talc used in the U.S. is imported from China. Protech has access to other talc properties near the Pioneer Mine and has a processing plant in Victorville.



Pioneer Talc Mine, San Bernardino Co.

Granite Construction, Ludlow Pit (PRC 8272)

Granite Construction Co. (Granite) acquired this 80-acre lease in San Bernardino County from Washington Group International (WGI). The CSLC approved the assignment in August 2005. The resource consists of alluvial material mined for sand and gravel. The mine's location near Ludlow makes it a desirable source of raw



Ludlow Pit, San Bernardino Co.

materials for repaving work along Interstate 40. Granite hopes to be the winning bidder for a contract to repave the western portion of Interstate 40. A total of \$32,391.45 in revenue was received from the lease during the year.

Granite Construction, Palm Desert Pit (PRC 7945)

Granite Construction Co. (Granite) continues operations at a large sand and gravel mine near Palm Desert in Riverside County. The school land parcel consists of 560 acres with a 1/16th reserved mineral interest. The State's royalty is \$0.04 per ton. Revenue from the parcel totaled \$79,800.97 for the year.

Jacobson Construction (W 40783)

Jacobson Construction (Jacobson) operates a sand and gravel pit west of the town of Baker in San Bernardino County. The alluvial deposit contains the raw materials needed for road construction along Interstate 15 and other local building projects. Staff continues to monitor Jacobson regarding sand and gravel extraction on the 45-acre parcel of which the State owns a 1/16th mineral interest.



Mineral Prospecting Permits

Southern Clay Products (PRC 8571)

Southern Clay Products (SCP) currently holds a two-year mineral prospecting permit on a remote school lands parcel in Inyo County near the Nevada border north of Death Valley. Issued in 2004, the permit covers property owned by SCP, with subsurface minerals reserved to the State. SCP plans to conduct a shallow drilling and sampling program to determine the depth and lateral extent of a clay resource underlying the property. However, SCP has not yet initiated this program, and the permit is scheduled to expire on October 31, 2006. The permit does allow SCP to apply to the CSLC for an extension.

Mineral Lease Applications

Granite Construction, Liberty Quarry Project (W 40904)

In December 2004, Granite submitted an application for a negotiated lease on 160 acres in Riverside County to mine granitic rock for use in producing sand and gravel. The proposed site, named the Liberty Quarry, is south of Temecula near the Riverside-San Diego County line. An adjacent 151-acre parcel where the State also owns a 1/16th interest will be included in the project.

The proposed quarry will have an anticipated life of 80 years, and revenue to the State is estimated to exceed cumulative revenue from all the other solid mineral leases. The Liberty Quarry site is ideally located for supplying construction aggregate for the rapidly-growing area of southwestern Riverside and northern San Diego Counties.



Granite's application remains incomplete pending receipt of documents from Granite and Riverside County. Riverside County is the lead agency for the preparation of a CEQA document and for a Mining and Reclamation Plan. During the year, Granite held public scoping meetings as required under the CEQA prior to preparation of a draft EIR.

Bureau of Reclamation (PRC 6735)

The U.S. Bureau of Reclamation (BOR) intends to reactivate a mineral extraction lease on the Manchester Quarry in the Dead Mountains in northeastern San Bernardino County. The BOR proposes to extract 2.8 million tons of rock over a 25-year period to be used as riprap for riverbank stabilization along the Colorado River for the protection of life and property.



Staff continued its coordination with the BOR, San Bernardino County, the State Department of Conservation's Office of Mine Reclamation (OMR), and the BLM. The OMR concluded biologic studies and prepared a Mining and Reclamation Plan for the project. The BOR submitted its application to San Bernardino County, but that application was deemed incomplete.

Hi-Grade Materials (W 40842)

Hi-Grade Materials Co. (Hi-Grade) applied in early 2005 for a mineral extraction lease at the Lucerne Valley Pit in San Bernardino County, but the application remains incomplete. Hi-Grade wants to expand its existing pit to alleviate



excessively steep slopes and extract more aggregate resources. The proposed expansion will involve approximately 113 acres of school lands. San Bernardino County approved Hi-Grade's revised plan of expansion in June 2006, but Hi-Grade has appealed certain terms of the mining and reclamation plan. The appeal needs to be resolved before staff can continue working with Hi-Grade to complete its application.

Cima Cinders (W 40880)

Staff continued to wait for additional information from Cima Cinders Co. (Cima) in support of its application for a lease on a school lands parcel in the East Mojave Desert in San Bernardino County. Cima intends to mine volcanic cinder aggregate from the parcel. Its parent company extracted cinders from the parcel in the 1950s, while developing a cinder-block market in the Las Vegas area and providing road-surfacing materials for local county roads and State highways. Cima maintains mining claims on adjacent Federal lands that contain similar volcanic aggregate deposits.

Mineral Exchange Applications

Kaiser Resources (W 40871)

Several years ago Kaiser Resources (Kaiser) submitted an application to acquire the State's reserved mineral interest in a 467-acre parcel of school lands near Desert Center in Riverside County, at the Eagle Mountain Mine Complex. In exchange, Kaiser proposed granting the State a partial interest in a nearby mineral estate owned by Kaiser and valuable for aggregate resources. The CSLC had issued a lease to Kaiser in 1978 covering 145 acres of the 467-acre parcel. The lease was within what is now a large open pit area covering several thousand acres. Iron ore was extracted from this pit for nearly 40 years, but operations ceased in 1982 when air quality laws and foreign competition rendered the deposit uneconomic. Kaiser's lease expired in December 2002.



Kaiser has been seeking a permit to operate a 5,000-acre landfill at the mine complex, utilizing the existing pits for landfill purposes. Applications to operate a landfill were approved by Riverside County, but in September 2005 a Federal District Court rejected a land exchange between Kaiser and the BLM necessary for the landfill to proceed. Kaiser is now awaiting its appeal to the court decision. If the landfill is fully approved, Kaiser plans to complete the sale of the Eagle Mountain Landfill to the Los Angeles County Sanitation District.

If the proposed exchange was consummated, the CSLC would participate in aggregate operations on approximately 2,400 acres retained by Kaiser to the west of the landfill. However, in late September 2005, Kaiser requested staff suspend work on the exchange pending resolution of the ruling by the Federal District Court.

Mineral Prospecting Permit Applications

Staff received several inquiries related to solid mineral resources during the year, but no actual applications for a mineral prospecting permit.

Abandoned Mine Reclamation Partnership

Staff continued to work with the Department of Conservation's Office of Mine Reclamation (OMR) in a partnership to reclaim abandoned mines. The OMR provides funding for necessary consultants and contractors, while staff of the CSLC provides time and expertise. The goal of the partnership is to inventory and remediate hazardous mine features on school lands parcels that could endanger the public and wildlife. In most cases, these hazardous features existed prior to the State's acquisition of the parcels.

During the year, inventories were conducted on numerous parcels in remote areas of the California Desert, and protective fencing was installed at potentially hazardous mine features at the Turtle Mine, Gold Standard Mine, Rusty Gold Mine, and the Los Padres Mine in Imperial, Riverside and San Bernardino Counties. Staff has identified more than 100 school lands sections that remain to be inventoried.



Typical field work associated with an inventory involves identifying the mines on topographic maps, navigating to those sites, and inspecting all mine features within each respective school lands section. Each inspection includes collecting data such as a description of the mine opening, a photograph of each feature (shaft, adit, prospect pit, etc.), and a measurement of its location with a global positioning system (GPS) instrument. A biologic consultant works with staff to determine any wildlife usage within the mine prior to designing an optimal closure technique. Remediation work is completed by a contractor and may include backfilling with waste rock, installing a polyurethane foam plug, or installing a bat-compatible steel gate. As part of the CEQA review process associated with the mine reclamation partnership, staff confers with the California Department of Fish

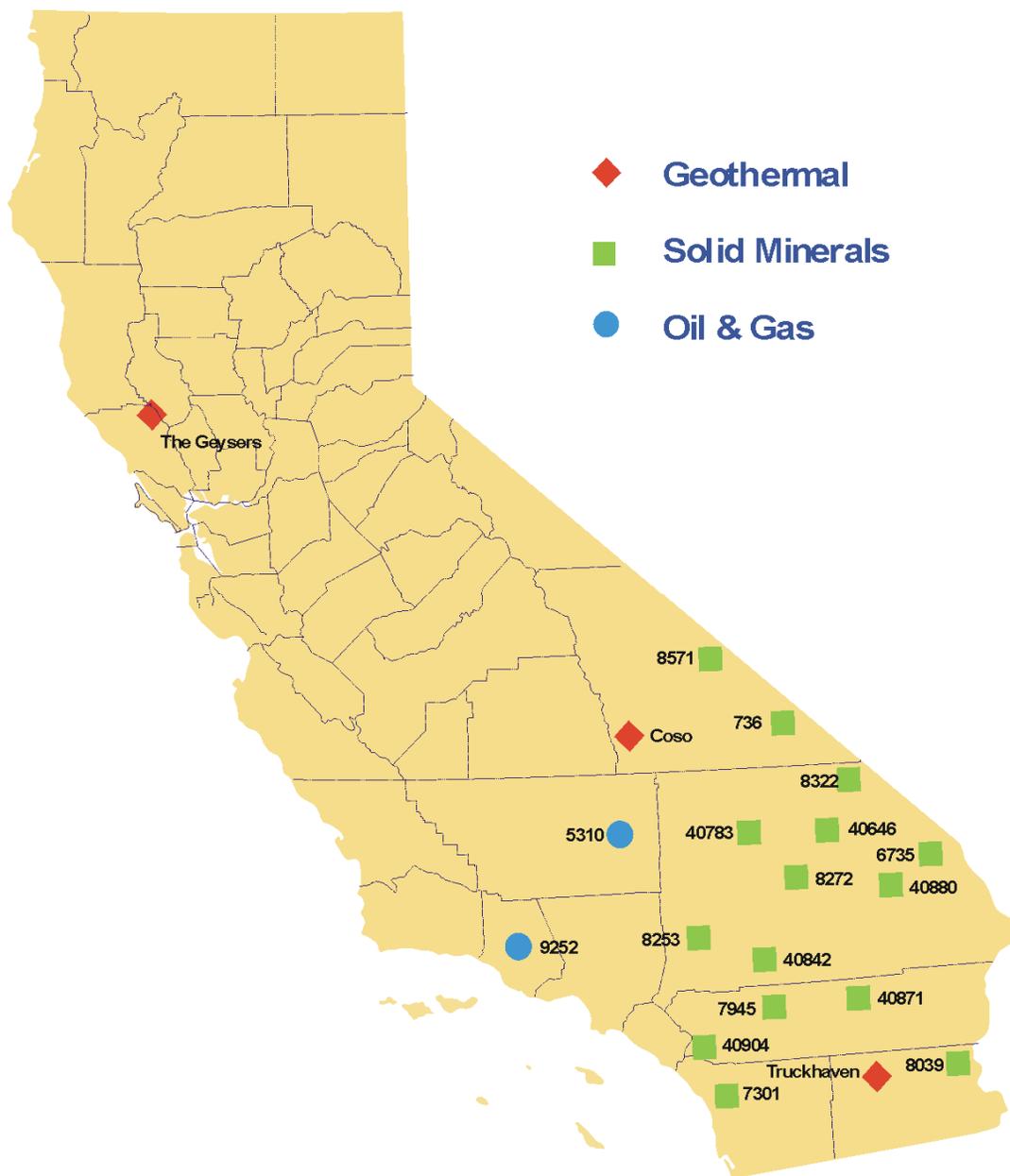
and Game (CDFG) and the State Historic Preservation Office. Concurrence is obtained from those agencies prior to conducting any mine closure work.

Staff was concerned that due to the magnitude of the problem and the rate of abandoned mine remediation, the most dangerous mine features may not be safeguarded for twenty years. Due to possible hazards posed to the public and wildlife, and potential liabilities to the State, the legislative fiscal committees held hearings on the issue and determined that the program needed to be accelerated. Consequently, a budget augmentation for the CSLC was recommended for FY 2006-07. The budget, if approved by the Legislature and signed by the Governor in July 2006, will allow the expenditure from the SLBF of \$2 million over three years and the hiring of two full time personnel to assist in the remediation efforts.

OIL & GAS PROGRAM

Revenue from the oil & gas program totaled \$501,472.02 for FY 2005-06, a 79% increase from the prior year. Oil production increased by nearly 23% on the two school lands parcels where the State has a 1/16th reserved mineral interest, while oil prices increased by 45% during the year. The vast majority of the revenue, \$500,216.40, came from the 160-acre Round Mountain parcel (VA 5310) located northeast of Bakersfield in Kern County. The parcel is part of a unit operated by MacPherson Oil Company. The balance of the revenue, \$1,255.62, came from the seven-acre Sulfur Crest parcel (LA 9252) located in the Santa Paula oil field in Ventura County.

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



**SUMMARY OF REVENUE GENERATED FROM GEOTHERMAL,
SOLID MINERALS, AND OIL & GAS PROGRAMS -
FISCAL YEAR 2005-06**

STRS FUND

Geothermal Royalties and Net Profits:

Royalties from leases at The Geysers:	\$ 4,696,886.45
Royalties from 1/16 th agreement at The Geysers:	\$ 10,441.49
Net Profits from lease at The Geysers:	\$ 798,400.78
Geothermal Total:	\$ 5,505,728.72

Solid Minerals Royalties:

Royalties from leases:	\$ 186,760.59
Royalties from 1/16 th agreement:	\$ 79,800.97
Solid Minerals Total:	\$ 266,561.56

Oil & Gas Royalties:

Oil & Gas Total:	\$ 501,472.02
-----------------------------	----------------------

TOTAL GROSS REVENUE: \$ 6,273,762.30

FISCAL YEAR 2006-07 PLANNED ACTIVITIES

GEOHERMAL PROGRAM

The Geysers

Staff estimates royalty and net profit revenue from school lands geothermal leases at The Geysers will again reach \$5 million in FY 2006-07. Steam production and prices are expected to remain relatively stable. Potential for further development exists on one of the seven State leases held by Geysers Power Co. Staff will continue its review of the lessee's development plan for the 1,881-acre lease issued in 2004. Consideration of the formal approval of that plan by the CSLC is anticipated during FY 2006-07.



Staff also plans to encourage Geysers Power Co., and other potential geothermal operators, to consider leasing or exploring unleased school lands in the extreme northwest part of The Geysers field. The success of increased water injection at The Geysers could make formerly noncommercial portions of the geothermal reservoir usable.

Geothermal Permits and Applications

Staff plans to work with Deep Rose as it pursues plans to drill an exploratory well in Inyo County under the geothermal prospecting permit issued by the CSLC. Staff also plans to encourage and work with the two applicants for geothermal prospecting permits in Imperial County to further the exploration for geothermal resources on school lands.

SOLID MINERALS PROGRAM

Mineral Lease Management

Staff estimates that revenue from school lands solid mineral leases will exceed \$300,000 in FY 2006-07. The anticipated increase would result from reactivation

of currently idle mining operations on certain existing leases and an increase in production on others.

Staff expects Western Mesquite to resume operations at its Mesquite Gold Mine, as gold prices have more than doubled and will make renewed mining economic. Staff expects San Bernardino County to approve Sigma's application to expand its operations at the Black Angel Quarry to utilize more of the 160-acre State lease, which will markedly increase production. Staff expects a resumption of production at Granite's idle Ludlow Pit if Granite can win contracts with Caltrans for widening and repaving portions of Interstate 40. Granite is in a good position to be the winning bidder, as its Ludlow Pit is favorable location. However, staff expects U.S. Borax to quitclaim its lease for the Gerstley Mine during the year.

Mineral Lease Applications

Staff plans to continue processing several leasing projects in FY 2006-07 that should result in new mineral leases within a few years. Those leases will have a significant positive impact on the revenue generated by the solid minerals program.

Staff anticipates resolution in early 2007 of Hi-Grade's appeal of San Bernardino County's terms for a mining and reclamation plan for its Lucerne Valley Pit. As a result, a negotiated lease should be ready for consideration by the CSLC in the latter part of FY 2006-07, with actual mining expected to commence the following year.

Staff plans to continue working with San Bernardino County and BOR during the CEQA review of BOR's proposal to reactivate its Manchester Quarry. That review is not expected to be completed until FY 2007-08, at which time the CSLC can consider issuing a new lease to BOR for mineral extraction. Staff estimates that revenue from that lease could exceed \$3 million over the expected 25-year project life.

Staff expects the CEQA document for Granite's proposed Liberty Quarry to be available late in FY 2006-07, and a use permit issued by Riverside County in FY 2007-08. Therefore, issuance of a new lease would not be considered by the CSLC until FY 2007-08. However, the revenue from this lease is expected to exceed \$1 million per year once operations begin.

Staff plans to contact Cima as to its intentions relative to the application it submitted for a lease to extract volcanic cinder aggregate. Cima made no attempt to further the application during the past year.

Mineral Exchange Applications

Staff does not anticipate completing Kaiser's proposed mineral exchange during FY 2006-07. Kaiser has placed its proposal on hold pending appeal of the Federal District Court ruling regarding its land exchange with the BLM, which is likely to require a significant length of time to resolve.

Mineral Prospecting Permit Applications

Given the rapid escalation in the price of precious metals, staff anticipates an increase in the number of inquiries and applications for permits to prospect for gold and silver. However, staff expects aggregate to remain the most significant solid mineral commodity extracted from school lands. There will be a continued need for aggregate as a construction material in response to booming real estate growth in many parts of Southern California.

Abandoned Mine Reclamation Partnership

With the additional economic resources available for abandoned mine remediation (see, *Abandoned Mine Reclamation Partnership*, page 20), the CSLC will seek to hire and train qualified personnel to accelerate the inventory and remediation of abandoned mines on school lands. Staff will continue to work with the OMR to maximize these efforts. Several mine closures are planned during FY 2006-07, including mines in the Cargo Muchachos, as well as the Stone Cabin, Los Padres, Gold Standard, and Arnold Edward mines. Staff is planning to coordinate closely with OMR in the goal of completing the inventory of mine features on school lands within a two year period. Closure work will continue concurrently with the inventory so that the danger to the public and wildlife is minimized.

OIL & GAS PROGRAM

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

FINANCIAL SUMMARY: FISCAL YEAR 2005-06

STRS FUND

REVENUES AND EXPENSES

Revenues:

Surface Rentals	\$	149,313.99
Miscellaneous Income	\$	2,273.31
Geothermal	\$	5,505,728.72
Solid Minerals	\$	266,561.56
Oil and Gas	\$	501,472.02
GROSS REVENUES	\$	6,425,349.60
Less: Geothermal Resource Development Account (GRDA) Deposits.....	\$	<68,722.40>
(Public Resources Code Section 3826)		
TOTAL	\$	6,356,627.20

EXPENSES: Net Management Costs

Land Management.....	\$	366,828.85
Geothermal	\$	303,612.02
Solid Minerals	\$	226,665.88
Oil and Gas	\$	2,381.40
Ownership Determination	\$	76,707.36
GROSS EXPENSES	\$	976,195.51
Less: Reimbursement Recovery	\$	<59,255.76>
TOTAL EXPENSES	\$	916,939.75

NET REVENUE TO STRS \$ **5,439,687.45**

SCHOOL LAND BANK FUND

Balance as of July 1, 2005.....	\$	49,691,523.03
SMIF Interest Earned Fiscal Year 2005-06.....	\$	1,965,835.76
Revenue from Land Sales	\$	2,794,912.24
Less: Contracts for Investment Services.....	\$	<5,570.00>
BALANCE OF FUND AS OF JUNE 30, 2006	\$	54,446,521.03

ABBREVIATIONS

BIA	U.S. Bureau of Indian Affairs
BLM	U.S. Bureau of Land Management
BOR	U.S. Bureau of Reclamation
Caltrans	California Department of Transportation
CDFG	California Department of Fish & Game
CDPA	California Desert Protection Act
CEQA	California Environmental Quality Act
CSLC	California State Lands Commission
EIR	Environmental Impact Report
FY	Fiscal Year
GPS	global positioning system
LEA	Layman Energy Associates
LLC	Limited Liability Corporation
LMD	Land Management Division
MRMD	Mineral Resources Management Division
OMR	State Office of Mine Reclamation
PRC	Public Resources Code
RFP	Request for Proposals
SLBF	School Land Bank Fund
SCP	Southern Clay Products
STRS	State Teachers' Retirement System
SVRA	State Vehicular Recreation Area
USB	U.S. Borax, Inc.
WGI	Washington Group International