

**MINUTE ITEM**

**This Calendar Item No. C25  
was submitted for information  
only, no action thereon  
being necessary.**

INFORMATIONAL  
CALENDAR ITEM

**C25**

A )  
S ) Statewide

12/17/92  
W 23691  
Reese

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

**PARTY:**

State Lands Commission  
1807 - 13th Street  
Sacramento, California 95814

P.R.C. Section 6477 provides for the submittal of an annual report on the management of school lands by the Commission to the State Teachers' Retirement Board, the Legislature, and the Governor.

The report addresses the school lands asset, composed of approximately 570,000 acres of school land and 760,000 acres of reserved mineral interest. Current revenues from such lands are dedicated to the State Teachers' Retirement Fund (STRF). Proceeds from land sales are deposited in the School Land Bank Fund (SLBF) for eventual reinvestment. In fiscal year 1991-92, surface and mineral leases produced a net revenue of \$3,880,802 to the STRF. Land sales produced a net income of \$1,016,706 for the SLBF. The accrued interest on this fund for the year was \$450,165.

The report was submitted to the State Teachers' Retirement Board, to the Legislature, and the Governor on October 8, 1992.

A copy of the report is attached as Exhibit "A".

**AB 884:**

N/A.

**EXHIBIT:**

A. Annual Staff Report on Management of School Lands

**EXHIBIT "A"**

**CALIFORNIA STATE LANDS COMMISSION**

**ANNUAL STAFF REPORT**

**ON**

**MANAGEMENT OF SCHOOL LANDS**

**Fiscal Year 1991-92**

**COMMISSIONERS**

Gray Davis, State Controller, Chairman  
Leo T. McCarthy, Lieutenant Governor  
Thomas W. Hayes, Director of Finance

**EXECUTIVE OFFICER**

Charles Warren

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

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**INTRODUCTION**

The State Lands Commission (SLC) manages approximately 570,000 acres of School Lands and 760,000 acres of lands with reserved mineral interest. Approximately 52,000 acres of lieu lands are still owed California by the Federal Government. Management of the School Lands is divided among two Divisions. The Surface Management Program is part of the Land Management Division and manages all surface resources. The Geothermal Program within the Mineral Resources Management Division oversees all geothermal activities. The Mineral Program, also within the Mineral Resources Management Division, oversees School Land oil and gas leasing and mining activities. School Lands staff continues to be augmented by other Commission staff from the legal, boundary determination, legislative, and accounting units.

The School Lands program continues to be committed to revenue enhancement of the School Lands asset. Last fiscal year management costs to operate the School Lands program was \$1.4 million. The 1991-92 management costs were reduced to \$733,813.00, largely due to reductions in the Commission's budget and resultant staff losses, many of which were in the School Lands Management program. It should be noted that those staff losses may also result in reduction of School Land sales activities and revenues. Lease revenues should not decline due to the fact that they are existing and, in most cases, have several years left on their term. Uncertainty over the size and location of lands to be included in a California Desert Protection Act has halted efforts to complete exchanges with the Bureau of Land Management.

**LAND MANAGEMENT DIVISION--SURFACE MANAGEMENT PROGRAM  
1991-92 SIGNIFICANT ACCOMPLISHMENTS**

The Surface Management Program within the Division of Land Management oversees management of all surface activities on State School Lands. This includes surface leasing for various purposes, sales, and the management of 25,000 acres of timberland. This fiscal year timber sales generated revenue of \$36,676 and surface rentals generated revenue of \$233,048, totalling \$269,724 of gross revenue for the State Teachers Retirement System. Land sales produced revenue of \$1,016,706. Accrued interest on the School Land Bank Fund was \$450,165.

**SALES**

**Ocotillo Wells:**

The Commission approved the sale of 4,331 acres of land in Imperial County near Anza Borrego State Park to the Department of Parks and Recreation. The purchase price was \$596,606.

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**Bureau of Land Management (BLM):**

Staff has completed the sale of 408 acres of School Land in San Bernardino County to the BLM. This BLM acquisition provides additional acreage to the Razor Off-Highway Vehicle Area. This sale was completed in November 1991. The purchase price was \$54,600.

**Meridian Oil, Inc.:**

This sale included 135 acres of State lieu land to facilitate construction of a pipeline lateral to a generating station owned by Southern California Edison Company in San Bernardino County. The purchase price was \$365,500.

**PLANNED SALES 1992-93**

**Kern River Gas Transmission Co. & Mojave Pipeline Co.:**

The Commission approved several leases to Kern River Gas Transmission Company and Mojave Pipeline Company for natural gas transmission pipelines and related facilities. As part of the environmental process, the applicants were required to acquire mitigation lands for their projects' impacts on threatened and endangered species. The Commission negotiated the equivalent of a right of first refusal to sell School Lands to fulfill the mitigation requirements. The amount of School Lands being considered is approximately 10,000 acres with approximate value of \$900,000. Negotiations are continuing regarding total acres involved and the sale should be consummated by the spring of 1993.

**U.S. Army Corps of Engineers, Sierra Army Depot:**

The Commission approved the sale of 16,282 acres of land in Lassen County, to the U.S. Corps of Engineers, which has leased the site since 1942. The purchase price is \$1,303,000. The sale will be completed in October, 1992.

**Salvage Timber Sale:**

The Fountain Fire in Shasta County consumed a 40 acre parcel of land containing approximately 1,000 mbf of timber. Staff is evaluating the situation and may recommend the approval of a salvage timber sale to the Commission. The estimated value of the burned timber is \$300,000.

## EXCHANGES AND INDEMNITY SELECTIONS

### Barstow II Exchange (BLM Lands in Homestead Valley, San Bernardino County):

A physical inspection of the BLM exchange properties indicated that they are not desirable for management. It does not appear that BLM is willing to offer any prime real estate for exchange. Therefore, the exchange as originally proposed has been terminated.

### Ward Valley Indemnity Selection:

The indemnity selection filed on behalf of the Commission has been maintained. The Department of Health Services has independently filed for direct purchase. The Bureau of Land Management is currently processing both applications.

### Phase II United States Forest Service:

Negotiations have been completed between the U.S. Forest Service and SLC to exchange scattered School Land parcels within National Forest boundaries for a consolidated holding of 2,274 acres of timberland in Butte County stocked with approximately 61 million board feet of timber, that has an approximate value of \$16.5 million. The Commission approved the Phase II Land Exchange at its August 12, 1991, meeting. Parties are currently negotiating a Programmatic Agreement covering cultural resources within the lands to be exchanged.

### 1992-93 Planned Exchanges and Selections:

None are planned, other than those identified above.

## MINERAL RESOURCES MANAGEMENT DIVISION - GEOTHERMAL AND MINERAL PROGRAM

The objective of the program is managing the orderly development of geothermal and mineral resources on School Lands. This is accomplished through issuance of leases and approval authority over all operations conducted on the leases. This responsibility involves maximizing revenue generated from resource development activities consistent with the best interests of the State, and ensuring that such activities are consistent with public safety considerations and environmental protection.

The only geothermal resources currently being produced from School Lands are those located in Lake and Sonoma Counties at The Geysers, the largest geothermal development in the world. Continued declines in steam production from the field,

together with decreases in steam prices during 1991-92, resulted in a royalty revenue total of \$4.32 million. This is up slightly from last year's total of \$4.17 million because of some late payments, back royalty and penalty and interest amounts that were collected during the year. Some of the production upon which these amounts were based actually occurred in the previous year. Overall, progress was made in 1991-92 in finding solutions to declining steam production, improving future steam prices, keeping all leases on production, and developing untapped School Lands resources at The Geysers.

Mineral development from the five existing leases on School Lands declined during 1991-92 to approximately \$46,357. Implementation of a reimbursement policy helped reduce management costs through the recovery of over \$20,000 in processing and filing fees and acreage deposits.

### The Geysers:

No new wells were completed on State leases at The Geysers during 1991-92. This lack of drilling is a direct result of declining steam reserves and reservoir pressure in the heart of the field and the overall decrease in steam prices. This is especially true for Unocal's leases, where the State derives about 75-80% of its royalty revenue. Only Santa Fe Geothermal, Northern California Power Agency, and Calpine Corporation drilled new wells in the past year. These operators enjoy steam prices notably higher than those paid by PG&E to Unocal, or they operate their own power plants. Unocal has not drilled a new well in the past three years.

The State's second largest lessee, Central California Power Agency (CCPA), received assignment of three State leases from Geothermal Resources International, Inc. (GRI) during 1991-92. This rescued these leases from bankruptcy and a possible shut down. Calpine has proposed one new well for 1992-93 on its State lease.

The field generated an average of only 1,400 megawatts during 1991-92, well below the 2,000 megawatt total of power plants constructed. The Department of Water Resources geothermal plant and one PG&E plant have been idle for over two years. Other plants are operating at far less than capacity, including most of those utilizing State steam. In the past year, PG&E retired their four oldest generating units, redirected the steam to more efficient plants, and modified their operation of plants to make the best use of the declining steam supply. Other plant operators are undertaking similar modifications. All parties involved at The Geysers are seeking ways to alleviate the productivity problems plaguing the field, and staff is involved in this effort. Two possible ways are to lease more land for exploration and development, and to increase injection of water acquired from sources outside of The Geysers.



Discussions were initiated on a project that would bring municipal wastewater effluent from the Clear Lake area to The Geysers via a 28-mile pipeline. The effluent would be used to augment the limited water available for injection. Staff is encouraging steam suppliers and plant operators to pursue the project since it could theoretically extend the life of the reservoir.

A programmatic Environmental Impact Report (EIR) on the leasing of 6,230 acres of State School Land at The Geysers was completed through efforts of staff and Chambers Group, Inc., and certified by the Commission during 1991-92. It is anticipated that up to 6,230 acres will be leased in 1993 for further development. This should provide additional revenues beginning in 1993.

**Geysers Royalty Revenue and Steam Prices:**

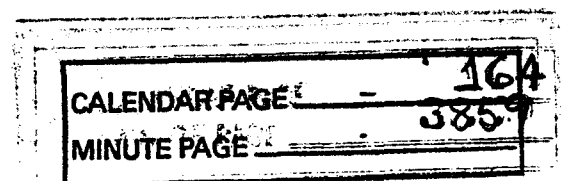
Geothermal royalty totalled \$4,323,745 in 1991-92. This included \$3,348,198 from Unocal leases, \$832,437 from CCPA leases, and \$143,110 from the Calpine lease.

Royalty revenue is a function of steam production, which continued to decline, and steam prices, which also declined in the past year. Production from all State leases decreased an average of 4% from the previous year. Some royalty collected in 1991-92 was actually based on production that occurred in 1990-91.

The price PG&E pays Unocal for steam decreased from \$16.22 per megawatt-hour in 1991 to \$14.15 in 1992, a 13% decrease. This price translates to about \$0.71 per thousand pounds of steam. However, this price may change because during 1991-92 PG&E and Unocal settled long-standing litigation concerning operations and pricing at The Geysers. Staff analyzed this settlement and the new steam sales agreement both internally and in a public workshop conducted by staff. The Commission approved the agreement at the end of the fiscal year. Approval by the Public Utilities Commission (PUC) is pending. Staff estimates the new price will be 25% higher than the old price and will go into effect in 1993.

Prices on the CCPA leases and the Calpine lease decreased by about 2% to \$2.00 and \$2.16 per thousand pounds, respectively. However, the price for CCPA was reduced later in the year to \$1.00 per thousand pounds. This reduction was negotiated by staff in order to prevent CCPA from closing their plant and abandoning the State steam resources. As a result, CCPA purchased three State leases as part of the settlement of the Federal Bankruptcy Court case involving GRI, and they have continued to operate their plant. CCPA also promised to pay any back royalty, penalty or interest not paid from the bankruptcy settlement.

**Geysers Corrosion and Contaminant Problems:**



Corrosion problems associated with high chloride content in steam produced in the Northwest Geysers, including State leases, continued to be mitigated successfully during 1991-92. However, Unocal cites this problem, along with economics, as the reasons for their unwillingness to develop additional State lease acreage in the Northern Geysers. Their new steam sales agreement with PG&E could allow Unocal to explore other options for some of this land, including sale of steam to other plant operators.

Non-condensable gases continue to be a problem in specific parts of the field because of levels which exceed the design limits of the power plants. Staff continues to work with operators to find technical solutions to the corrosion and steam contaminant problems. Staff has investigated the feasibility of small wellhead generators to utilize this gassy corrosive steam. Though technically feasible, the economic feasibility is dependent on current steam and power sales contracts which have been unfavorable.

**Lawrence Berkeley Laboratory Geysers Study:**

The contract with Lawrence Berkeley Laboratory (LBL) for reservoir modeling of The Geysers was not renewed for 1991-92. However, LBL worked with staff on analyzing and applying the results of studies performed in 1990-91. The three-dimensional numerical model of the Northwest Geysers developed by LBL shows that significant quantities of steam have migrated both into and out of State leases prior to development of one of the leases. After that lease was developed, this steam migration was reduced. Much of the historical migration appears to have occurred from one State lease to other State leases developed years earlier.

Projections of future reservoir performance suggest that the CCPA plant area in the Northwest Geysers could sustain 60-65 megawatts, the equivalent of one of the two turbines installed there, with the drilling of a limited number of wells. However, the reservoir area currently dedicated to the plant will not be able to sustain the plant at 130 megawatts. The model can now be used to determine the optimum location for the limited number of new wells that will be required to sustain 60 megawatts.

Additional reservoir modeling studies will be conducted primarily in-house, at a savings of approximately \$100,000 per year. LBL is currently assisting staff in installing the model. Staff is also working closely with lessees in sharing the reservoir modeling results which should help in maximizing the recovery of geothermal resources from State School Lands.

**Geysers Technical Advisory Committee:**

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SLC was an active major participant in The Geysers Technical Advisory Committee (TAC) during 1991-92. The TAC consists of steam field operators, power plant operators, mineral owners and County, State and Federal regulatory agencies.

An Interim Coordinated Resource Management Plan was developed by steam suppliers and plant operators. It recommended five elements -- 1) improvement in power plant efficiency (or shifting steam to more efficient plants), 2) additional water injection, 3) power plant operation utilizing variable generation, 4) additional drilling in underdeveloped areas, and 5) improvement in steam quality between reservoir and power plant. Implementation of some of these elements must await the results of the TAC-sponsored efforts to model the entire reservoir, the pipeline system, and the power plants. These modeling efforts are scheduled to be completed early in 1992-93.

#### **Truckhaven Geothermal Exploration:**

Staff is assisting Magma Power Company in developing five School Lands parcels west of the Salton Sea in Imperial County. Magma and Unocal have proposed a geothermal unit for possible future development. A discovery well was drilled there in 1982, but commercial development has not been achieved due to a lack of a power sales contract. With the prospect of new power sales contracts becoming available in Imperial County in the near future, the Truckhaven project has real potential for development. The State parcels comprise a 3,082-acre lease that would be part of the unit. Magma is meeting quarterly with staff to discuss their exploration program. The drilling of several shallow temperature wells and a deep production well is anticipated in 1992-93.

#### **Mineral Prospecting Permits:**

During 1991-92, staff issued one hard mineral prospecting permit to the Palms Mining Company. The exploration target for this permit is gold and silver mineralization in a zone of overthrusting - a favorable host structure for minerals. Currently, there are five active prospecting permits on School Lands.

#### **Mineral Extraction Leases:**

At the end of 1991-92, there were five active mineral extraction leases and one application pending. Revenue from the existing industrial mineral and aggregate leases declined during the year because of the continuing nationwide economic downturn in manufacturing and building. Hard mineral revenue for 1991-92 totalled approximately \$46,357.

#### **Fort Irwin Exploration:**

The State Lands Commission manages some 40 parcels of reserved mineral interest land totalling over 25,000 acres within Fort Irwin, the National Training Center, San Bernardino County. In an effort to reduce electrical power costs, the Army Post Commander has authorized a program to explore for geothermal resources at the Fort. An Environmental Impact Statement (EIS) prepared by Fort Irwin is in circulation. It covers a program of geophysical surveying and a 5,000 foot test well to be drilled in August 1992. The State, because of its checkerboard mineral ownership pattern within the Fort, may participate in any commercial geothermal resource development through a pooling of Federal and State lands for recovery of the resource.

The Post Commander is also proposing a program of multiple use for lands within the Fort to allow private hard mineral development. Because Federal and State interest lands within the post are not continually utilized by the military, mining could be allowed if the operations are interrupted for a few weeks each year to accommodate military exercises. Fort Irwin and Army personnel are investigating legislation to support the multiple use concept. Staff is actively monitoring the status of the geothermal and hard mineral proposals at Fort Irwin.

#### **Cost Recovery:**

In accordance with agency policy, staff has implemented a program of reimbursement funding for the costs of processing the various applications and transactions related to mineral resources and mineral estates. Reimbursement accounts have been established to cover processing costs required for new applications. Over \$20,000 has been recovered in 1991-92 as processing and filing fees and acreage deposits. Implementation of the reimbursement policy is helping to reduce mineral management costs, thereby increasing the net return from mineral revenues to the State Teachers Retirement Fund.

#### **Oil and Gas Activities:**

The single oil and gas lease on State School Lands (with a 1/16th reserved mineral interest) continued to produce revenue during 1991-92 although at a declining rate. This lease first produced oil in 1928. Oil and gas revenue for 1991-92 totalled approximately \$12,292.

### **1992-93 PLANS**

#### **Future Geysers Revenue and Prices:**

Royalty revenue from existing leases is expected to total \$4,300,000 for 1992-93. Bonus bid income will add to this revenue. The \$4.3 million includes approximately \$500,000 from Unocal as its share of the settlement of a fuel inventory writedown

claim Unocal had against PG&E. It also includes approximately \$200,000 to be released from a disputed royalty account involving the CCPA lease and past pricing provisions.

Despite recent price drops, future steam prices are expected to rise slowly, including the new PG&E price, and prices adjusted by the Producer Price Index and the Gross National Product Implicit Price Deflator. The new steam sales agreement between PG&E and Unocal, approved by the Commission in 1991-92, will result in a price increase of about 25%, once it is approved by the PUC and goes into effect. However, higher prices will not offset the anticipated decline in steam production.

**Future Geysers Leasing:**

Following certification of the EIR in 1991-92, staff is identifying the parcels to be offered for lease, preparing the form of lease, and the nature of the biddable factor for up to 6,230 acres of School Lands at The Geysers. If approved by the Commission, a lease sale is anticipated during 1992-93 which could add significantly to revenues, depending upon the bonus bid results. Development would be one or more years later because of the need to determine resource extent through exploration, prepare a plan of development, and perform subsequent environmental analysis. It is possible that a new plant may be proposed if warranted by newly discovered resources, or that steam pipelines can be connected to existing plants. In any event, there is a prospect for additional development of steam resources from State School Lands.

**School Lands Geothermal Evaluation:**

Staff is initiating an updated inventory and evaluation of School Lands located near areas with geothermal development or potential. These areas include the California Desert, the Imperial Valley, the Eastern Sierra, and the northeastern part of the State. The exploratory geothermal well and proposals for hard mineral development at Fort Irwin will be monitored as part of this effort for the possibility of revenue generation for STRS. Staff is assembling maps of School Lands and mineral interests for other areas that will aid in planning for new geothermal development and the State's participation.

**Mineral Permits and Leases:**

Staff is currently processing eight new prospecting permit applications for School Land sections. The application for a mineral extraction lease is waiting completion of the environmental review and permitting of the project by the Bureau of Land Management and San Bernardino County. Cost control efforts and reimbursement of staff costs for processing public applications will continue.

## LEGISLATION

### PENDING FEDERAL LEGISLATION

#### H.R. 2929 - "California Desert Protection":

H.R. 2929 would set aside 4.3 million acres of Bureau of Land Management (BLM) wilderness and transfer another 3 million acres of BLM land to the National Park Service. It would encompass 263,000 acres of State School Land -- almost 50 percent of the remaining School Land trust grant surface ownership. An additional 53,000 acres of School Land reserved mineral interest would also be included.

Section 610 of the bill provides for the exchange of the 316,000 acres of State School Lands for lands of the Interior Department. These lands may include lands with potential for mineral or geothermal development that are not currently producing revenue and Bureau of Reclamation lands no longer required for project operations. If, as of October 1, 1996, there are State School Lands remaining in the park units and wilderness areas designated in H.R. 2929, the Secretary will establish in the name of the California State Lands Commission a "credit account" that may be used to bid, as any other bidder, for excess or surplus federal property being sold at public auction. In the event that the balance of the credit account has not been reduced to zero by October 1, 2000, Section 610 authorizes appropriations of the funds remaining in the account to compensate for the acquisition of the inholdings.

The bill passed the House on November 22, 1991. The Senate Energy Committee began debate on August 5, 1992. H.R. 2929 was proposed as an amendment to S. 1156, a bill to address the timber crisis in the Pacific Northwest, by Senator Timothy E. Wirth (D-Colorado). Senator John Seymour, who opposes H.R. 2929, moved to table Wirth's amendment. When that motion was defeated, Seymour invoked a procedural rule barring the committee from continuing markup once the full Senate had been in session for two hours. It appears that the bill will not be passed by the Senate during the 102nd Congress.

#### Fiscal Year 1993 Federal Budget - "Elk Hills":

The Bush administration in September 1992, strongly objected to the absence of provisions in either the House or Senate Interior Appropriations bills to allow private oil producers to lease land in the Elk Hills Naval Petroleum Reserve for oil drilling. The leasing proposal included in the President's budget would resolve with finality the State of California's claim of ownership and compensation to the retired teachers of California. Under the Administration's proposal, California would receive seven percent of any bonus payment, and one-half of lease royalties. The Administration's proposal for competitive leasing offers an opportunity to resolve this longstanding dispute. The conference committee completed its work on September 23, 1992.

However, the conference report has not been voted on by either the House or Senate.

### **LITIGATION**

Geothermal Resources International Development (GRID) and Geothermal Resources International Exploration (GRIE) (together the "Debtors") filed a petition in bankruptcy in June, 1989. During the course of the bankruptcy, the Debtors withheld \$659,045.65 in royalties, penalties and interest.

On March 31, 1992, the Debtors assumed the leases and assigned them to CCPA No. 1. On April 1, 1992, the Debtors paid the Commission \$425,618.06 in pre- and post-petition royalties. The Commission negotiated with the Debtors and entered into a court approved settlement agreement under which the Debtors paid the Commission \$210,000 in settlement of the penalty and interest charges.

Currently the Commission is negotiating with the Debtors' parent company and CCPA No. 1 for recovery of the additional monies.

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**FINANCIAL SUMMARY**

**Expenses and Revenues**

<b>Revenue:</b>	<b>Year-to-Date</b>
Surface Rentals .....	\$233,048
Geothermal .....	4,323,745
Oil and Gas .....	22,494
Minerals .....	46,357
Timber .....	<u>36,676</u>
TOTAL: Gross Revenues .....	\$4,662,320
Less; Geothermal Resources Development Account Deposits .....	(\$47,705)
(Public Resources Code Section 3826)	
TOTAL; School Lands Revenues (Subject to PRC 6217.5) .....	\$4,614,615
Net Management Costs:	
Land Management .....	\$518,442
Geothermal .....	297,096
Oil and Gas .....	12,292
Minerals .....	64,685
Ownership Determination .....	<u>29,152</u>
Total; Gross Expenditures .....	\$921,667
Less; Reimbursement Recovery .....	(\$187,854)
TOTAL; Net Expenditures .....	\$733,813
TOTAL; NET REVENUES TO TEACHERS RETIREMENT FUND .....	\$3,880,802

**SCHOOL LAND BANK FUND**

Balance as of June 30, 1991 .....	\$7,178,453
Deposits fiscal year 1991-92 .....	1,260
Interest fiscal year 1991-92 .....	450,165
Administrative Expenses .....	(\$23,178)
Total Balance as of June 30, 1992 .....	\$7,606,700
Receipts Pending .....	1,016,706
TOTAL .....	\$8,623,406

