

MINUTE ITEM
This Calendar Item No. C35
was submitted for information
only, no action thereon
being necessary.

INFORMATIONAL
CALENDAR ITEM
C35

A) 03/01/95
) Statewide W 23691
S) 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 1993-94, surface and mineral leases produced a net revenue of \$5,065,965.61 to the STRF. Land sales produced a net income of \$1,738,230.53 for the SLBF. The accrued interest on this fund for the year was \$449,024.90.

The report was submitted to the State Teachers' Retirement Board, to the Legislature, and the Governor on December 15, 1994.

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

AB 884:

N/A

EXHIBIT:

A. Annual Staff Report on Management of School Lands

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EXHIBIT "A"

CALIFORNIA STATE LANDS COMMISSION

ANNUAL STAFF REPORT

ON

MANAGEMENT OF STATE SCHOOL LANDS

Fiscal Year 1993-94

COMMISSIONERS

Leo T. McCarthy, Lieutenant Governor
Gray Davis, State Controller
Russell S. Gould, Director of Finance

EXECUTIVE OFFICER

Robert C. Hight

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

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INTRODUCTION

The State Lands Commission (SLC), through its State School Lands Management Program (Program), manages approximately 570,000 acres of School Lands held in fee ownership by the State and 760,000 acres of School Lands sold by the State in which mineral interests are reserved. In addition, approximately 52,000 acres of lieu lands are still owed to California by the federal government to satisfy the entitlements under the State's original grant. Management of the School Lands programs is divided among three staff divisions within the SLC as follows. The Divisions of Environmental Planning and Management and Land Management share responsibilities for the Surface Management Program under which all School Lands surface resources are managed. The Mineral Resources Management Division oversees both the SLC's Geothermal Program and the Mineral Program under which the School Land oil and gas leasing and mining activities are administered.

Program emphases continue to be the consolidation of capital resources, acquisition of additional long-term revenue producing properties and the sale of School Land parcels whose revenue potential is determined to be marginal. Past sales have occurred on the "open" market and to local or State entities.

Total Program net revenues were \$5,065,965.61 in Fiscal Year (FY) 1993-94. Management costs for the Program were \$481,341 in FY 1992-93. An approved Budget Change Proposal for the 1994-95 FY, effective January 1, 1994, increased the staffing level and budget for the SLC's management program to \$671,477. The authorized staff will offset reductions in the Commission's budget and staff which have occurred each year since the 1990-91 FY. During this period, the Commission's School Lands Management Program was correspondingly reduced in staff and scope which resulted in the postponement of some revenue opportunities for the State Teachers' Retirement System. With the additional positions authorized specifically for the Program, the following revenue producing activities will be pursued:

- 1) Continued geothermal resources lease management, primarily within The Geysers geothermal field;
- 2) Timber sales and salvage;
- 3) Exchange of timber for land; and
- 4) Selected land sales.

The President's signing of the California Desert Protection Act of 1994 (PL 103-433) initiates a major program effort to exchange approximately 330,000 acres of State School Lands within the protection area, worth more than \$40 million, for surplus federal lands with near and long-term revenue production. Section 707 of the Act directs the Secretary of the Interior to reach agreement with the State Lands Commission on an exchange process. Work is underway for that agreement which is expected to be signed in the 1994-95 FY.

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SURFACE MANAGEMENT PROGRAM

The Surface Management Program 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, surface rentals generated \$209,331.26 of gross revenue for the State Teachers' Retirement System. Land sales produced revenue of \$1,738,230.53. Accrued interest on the School Land Bank Fund for Fiscal Year 1992-93 and Fiscal Year 1993-94 was \$810,678.90.

FISCAL YEAR (FY) 1993-94 ACTIVITIES

SCHOOL LAND BANK FUND REVENUES

Sales revenue totalled \$1,738,230.53 from the following transactions.

Kern River Gas Transmission & Mojave Pipeline Companies

The Commission approved several right-of-way 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 habitats of threatened and endangered species. The Commission negotiated the equivalent of a right of first refusal to sell School Lands to the companies in fulfillment of their habitat mitigation requirements. Revenues from this transaction totalled \$1,688,930.53 (\$1,071,193.33 sales plus a \$617,737.20 transfer pending from Environmental Mitigation Trust Fund).

Southern California Public Power Authority

Five (5) fee parcels and three (3) easement parcels totalling 45.47 acres were sold for a right-of-way corridor for the Mead-Adelanto Project, a 1200-megawatt transmission system in San Bernardino County. Revenue from the transaction totalled \$49,300.00.

STRS REVENUES

Salvage Timber Sales

The Commission authorized staff to enter into emergency agreements (Title 2, C.C.R., Section 2034) to harvest insect killed and infested timber on parcels of school land. Costs of the salvage operation were offset by the revenue derived from the sale of the salvaged timber. Net revenues received for this fiscal year totalled \$6,744.52.

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FISCAL YEAR (FY) 1994-95 PLANNED ACTIVITIES

POTENTIAL SCHOOL LAND BANK FUND REVENUES

Staff of the Commission continues to identify parcels of land that have no surface lease revenue producing potential, but have potential to generate revenue through sale.

San Bernardino and Mendocino Counties

Ongoing plans to market approximately 25 parcels of land in San Bernardino and Mendocino Counties could result in net revenues of \pm \$1,000,000.

Department of Parks and Recreation

The closing of a proposed sale to the Department of Parks and Recreation, with an agreed upon purchase price of \$4,300,000, is anticipated in this fiscal year.

**State Department of Transportation and
Metropolitan Water District of Southern California**

Negotiations are currently underway for the sale of approximately 300 acres of land to the State Department of Transportation and the Metropolitan Water District of Southern California. The parcels are currently being appraised, but fair market value estimates are not yet available.

POTENTIAL STRS REVENUES

Salvage Timber Harvests

Revenue from salvage timber harvests necessitated by insect killed and infested timber should net in excess of \$200,000. Additional School Lands timber lands are being surveyed to determine the extent of insect infestations.

LAND EXCHANGES:

Forest Preserves and Production

Two, three-way exchanges involving the Commission's timber land in Mendocino County are pending. The exchanges are designed to protect specific sensitive watershed resource lands that are currently managed for timber production and harvest while allowing a comparable level of timber harvest activities to occur on State School Lands that are less sensitive. The State Teachers' Retirement Fund would be paid fair market value for the stumpage taken from the State's parcel.

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The California Desert Protection Act

For the last nine years, comprehensive federal legislation to provide permanent protection to significant areas of the California desert has been proposed. Recently signed into law, S 21, creates over 7.5 million acres of wilderness in the California desert. The measure constitutes the largest federal land withdrawal since the Alaska National Interest Lands Conservation Act of 1980 and the most wilderness ever designated in the 48 contiguous states. The bill will set aside about 3.5 million acres of Bureau of Land Management (BLM) land in 69 wilderness areas and another 2.92 million acres will be transferred to the National Park Service. The Death Valley and Joshua Tree National Monuments are also expanded from 2 million to 3.27 million acres and from 560,000 to 794,000 acres, respectively, and both will be upgraded to national parks. In addition, the East Mojave National Scenic Area will become a 1.42 million acre national preserve. The three parks will contain a combined total of 3.99 million acres of formally designated wilderness.

Approximately 330,000 acres of State School Lands will be enclosed within the various federal enclaves and wilderness acres. Under the law's provisions, the SLC will select and negotiate the exchange of School Lands for eligible federal lands. Per the provisions of S 21, staff, on behalf of the Commission, has requested the Secretary of the Interior to enter into an agreement to exchange federal lands for state-owned School Lands and has met with California BLM staff to begin the proscribed process.

GEOHERMAL, MINERAL, AND OIL AND GAS PROGRAMS

FISCAL YEAR (FY) 1993-94

The objective of the program is to prudently manage the development of geothermal, hardrock mineral, and oil and gas resources on State School Lands. The Commission issues lease agreements and prospecting permits, approves all operations conducted on the leases, verifies conformance with lease provisions, calculates proper royalty payments, and promotes programs and research that enhance resource recovery or its value. These actions are designed to protect the environment and public safety and maximize revenue generated from the resources consistent with the best interests of the State.

The Geysers

The Geysers geothermal field in Lake and Sonoma Counties remains the largest development of its kind in the world. Over 6,800 acres of School Lands are currently under lease to three geothermal operators: Unocal Geothermal, Central California Power Agency (CCPA), and Calpine Corporation. Fieldwide production continued to decline in FY 1993-94 as most plants, including those using steam from State leases, operated below capacity. However, the State's royalty revenue increased to \$5.3 million for FY 1993-94 due to higher prices for steam and the receipt of two large royalty adjustments. Revenue was about \$3.1 million in FY 1992-93.

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Drilling activity during FY 1993-94 continued to be slow, with only four new wells drilled in the entire field. Unocal, the largest leaseholder, has not drilled additional wells in the past five years. CCPA completed only one well, initially on private land, but later recompleted on a State lease. Calpine also drilled only one new well, but not on its State lease. Reduced levels of production account for the hiatus in drilling new wells.

The Geysers Technical Advisory Committee, of which staff was a part, recommended several remedial actions to be taken by field operators. Efforts to improve plant efficiency and inject additional water are two recommendations that have moved forward.

Facility modifications at several PG&E plants have resulted in measurable improvements in the efficiency of steam utilization, thus conserving the resource. The amount of steam required to generate a megawatt-hour of electricity at PG&E plants that use State steam has been reduced by about 5% over the past two years through this effort. The modifications were part of the settlement agreement between Unocal and PG&E, approved by the State Lands Commission in 1992, and by the Public Utilities Commission in 1993.

Based on its review of an EIR/EIS for a proposal to pipe treated wastewater, together with water extracted from Clear Lake, to The Geysers field for injection, staff encouraged lessees to pursue the project to replenish the steam reservoir. Although the additional water will not be injected on State leases, it may be near enough to cause positive benefits. The pipeline could be completed in late 1995. A similar pipeline project is being considered for wastewater from the City of Santa Rosa. Staff will follow the progress of that proposal, and evaluate its benefit to the State's resources.

Geysers Royalty Revenue and Steam Prices

Geothermal royalties received by the STRS totalled \$5.3 million in FY 1993-94. This includes \$4.72 million from Unocal leases, \$0.25 million from CCPA leases, and \$0.40 million from the Calpine lease. A significant portion, nearly \$1.5 million from Unocal and \$124,251 from Calpine, is royalty received in settlement of price disputes and production prior to FY 1993-94. Unocal's payment was for settlement of a FY 1988-89 dispute and application of a new steam price retroactive to 1992. Calpine's payment was in settlement of a FY 1992-94 price dispute.

Steam production and steam prices are the two factors that determine royalty revenue. During 1993-94, production continued to decline, but steam prices increased significantly. Steam production from State leases declined about 7% from the previous year, while the average steam price increased by about 25%, dominated by a rise in the PG&E-Unocal price. That price, based on electrical output rather than steam

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production, increased from \$12.97 to \$17.30 per megawatt-hour as a result of the settlement agreement. The increase was first applied in August 1993, but was retroactive to October 1992. For 1994, this price was adjusted downward slightly to \$17.10 per megawatt-hour as a result of changes in certain economic indexes. This price translates to about \$0.86 per thousand pounds of steam, using the average conversion efficiency of PG&E plants.

The average price paid by CCPA decreased 4% to about \$0.66 per thousand pounds. This price is a composite of \$1.05 for steam from the State's 100% reserved mineral interest lease, and \$0.41 for steam, supposedly of lower quality, from two parcels where the State has only a 1/16th reserved mineral interest. Average prices on the Calpine lease decreased 22% to about \$1.73 per thousand pounds following settlement of a dispute over the "market price". However, as part of the settlement, Calpine agreed to increase the royalty rate from 10.0% to 12.5%, maintain the original higher price for net profit accounting purposes, and execute a \$10,000 per year reimbursement agreement for lease inspection. Calpine also surrendered its claim to the \$124,251 in disputed royalty.

Geysers Leasing Efforts

During FY 1993-94, staff negotiated a new lease with CCPA in the northwest part of The Geysers. CCPA immediately drilled a producing well into the lease from an existing pad outside the lease. The new lease agreement includes a 10% royalty rate and a \$10,000 per year reimbursement agreement to be paid by the lessee for field inspection by staff. Staff also initiated negotiations with Calpine on another parcel.

Truckhaven Lease

Magma Power Company submitted a quitclaim of their lease of 3,082 acres of School Lands near Truckhaven on the western side of the Salton Sea in Imperial County. This lease was part of a large geothermal unit formed to explore and develop the resource there, although very little exploration was undertaken in recent years. Magma acquired a 100% interest in the lease in early 1993 when they purchased all of Unocal's Imperial Valley geothermal acreage and three generating plants. This acquisition, together with the current difficulty in obtaining new power sales agreements with the major electrical utilities, caused Magma to reassess their future development strategy, and they chose to relinquish a number of holdings as a result.

Oil and Gas Revenue

In FY 1993-94, \$17,981.34 was received as for royalty oil and gas production from a 1/16th reserved mineral interest parcel in the Round Mountain Oil Field.

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Mineral Extraction Leases

At the end of FY 1993-94, there were four active mineral extraction leases, with negotiations initiated between staff and the U.S. Bureau of Reclamation for renewal of one of them. Revenue from hardrock mineral leasing on School Lands, including royalty and rental payments, increased by \$88,928.36 for FY 1993-94. However, due to the mineral trespass described below, total revenue was \$241,173.36 for the year. The revenue from these active leases resulted from the extraction of industrial minerals, production of which has gradually increased due to a continuing nationwide upturn in the construction industry.

Negotiations were also started on two new mineral extraction leases, one with Kasler Corporation for sand and gravel, and one with Homestake Mining Company for precious metals.

Mineral Prospecting Permits

There are currently three mineral prospecting permits for precious metals exploration on School Lands. Two were issued in FY 1993-94 to Naxos Resources USA, Ltd. of Vancouver, Canada in the Death Valley Junction area of Inyo County. The other active permit is adjacent to Viceroy Gold Corporation's Castle Mountain mine. Staff also began processing two new prospecting permit applications and two amendment requests for existing permits.

Mineral Trespass Settlement

During FY 1993-94, staff negotiated a \$152,245 settlement with Tarmac California, Inc. for a quarry operation in trespass. The State's interest in the quarry is 1/16th of the value of minerals extracted, in this case sand and gravel. The settlement covered production during the five years prior to the sale of the quarry to Granite Construction Company. Negotiations with Granite to consummate an agreement covering their present and future mineral extraction from the quarry are in progress.

FISCAL YEAR (FY) 1994-95 PLANNED ACTIVITIES

Potential Geysers Royalty Revenue and Prices

Royalty revenue from existing leases is expected to total \$3.7 million for FY 1994-95. Steam prices are expected to rise slowly, but not enough to offset declining steam production. Resolution of a price dispute between private lease owners and CCPA could result in a more favorable steam price for the State leases. The differential is being placed into a disputed royalty account. Net profit revenue is not anticipated in the coming year from either of the State's two leases with net profit-sharing agreements, although the Calpine lease may be yielding net profit revenue within a few years.

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Geysers Leasing

Staff of the Commission will continue negotiations for a new lease with Calpine in the northwest part of The Geysers. Calpine and CCPA have expressed interest in two other unleased parcels, one in the north and one in the southeast, which may evolve into lease negotiations. Staff is also evaluating the prospect for future lease sales involving School Lands at The Geysers. If consummated, these new leases should enhance geothermal royalty revenue by FY 1995-96.

Additional efforts will also be made to lease the Truckhaven acreage quitclaimed to the State by Magma Power Company.

Mineral Extraction Leases

During FY 1994-95 staff will complete the processing of two lease applications on School Lands parcels, one for industrial minerals with Kasler in San Bernardino County and the other for precious metals adjacent to Homestake's McLaughlin Mine in Napa and Yolo Counties.

Mineral Prospecting Permits

Staff will complete the processing of applications for the amendment of two mineral prospecting permits, one for precious metals on School Lands near Death Valley Junction in Inyo County with Naxos, and one with Viceroy in the Castle Mountains of eastern San Bernardino County. Staff will also complete the processing of two mineral prospecting permit applications for precious metals, one in western Tehama County with Eagle Explores of Redding, California, and one with American Girl Mining Joint Venture in the Cargo Muchacho Mountains of southern Imperial County.

Mineral Trespass Settlements

Staff will continue to pursue two mineral trespasses on School Lands parcels in desert areas of Southern California. Detection and control of mineral trespasses is a joint effort involving the Divisions of Land Management and Environmental Planning and Management. Negotiations for settlement of these transactions were underway at the end of FY 1993-94.

FINANCIAL SUMMARY

REVENUES AND EXPENSES/FISCAL YEAR 93/94

Revenues:

Surface Rentals	\$ 209,331.26
Geothermal	5,308,201.69
Oil and Gas	17,981.34
Minerals	241,173.36
Timber	<u>6,744.52</u>
TOTAL:	\$5,783,432.17

Less: Geothermal Resources Development

Account Deposits	<u><\$45,989.38></u>
(Public Resources Code Section 3826)	
TOTAL: School Lands Revenues Subject to PRC 6217.5.....	\$5,737,442.79

Expenses: Net Management Costs

Land Management	\$ 289,724.68
Geothermal	352,396.70
Oil and Gas	6,249.75
Minerals	40,500.09
Ownership Determination	<u>28,791.26</u>
TOTAL:	\$ 717,662.48

Less: Reimbursement Recovery	<u><\$46,185.30></u>
TOTAL: Net Management Expenses	\$671,477.18

NET REVENUES TO STATE TEACHERS RETIREMENT FUND \$5,065,965.61

SCHOOL LAND BANK FUND

Balance as of September 30, 1993	\$10,174,860.00
SMIF Interest Fiscal Year 1992-93	361,654.00
SMIF Interest Fiscal Year 1993-94	449,024.90
Sales Deposits	1,738,230.53
Adjustment From Prior Year Expenditures	800.81

Less: Real Estate Consultant Contract	<9,493.20>
Real Estate Appraisal Contract.....	<11,385.00>
Real Estate Services MOU (O.P.D.M.)	<u><7,021.00></u>

BALANCE AS OF SEPTEMBER 30, 1994..... \$12,696,671.04