

CALIFORNIA STATE LANDS COMMISSION

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

Fiscal Year 2002-03

CALIFORNIA STATE LANDS COMMISSION

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

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INTRODUCTION

The California State Lands Commission (CSLC), through its State School Lands Management Program (Program) manages approximately 476,000 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 statutory trust in 1984 when the State Legislature approved the School Land Bank Act (Act), created the School Land Bank Fund (SLBF), and designated the CSLC as trustee of this fund. The Act added Sections 8700 through 8716 to the Public Resources Code (PRC), which set forth the management guidelines for the Program. 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 in the State Treasury to the credit of the School Land Bank Fund. PRC Section 6217.5 directs all net revenues derived from the use of school lands (for example, royalties, rents, and interest generated from promissory notes) be deposited into the State Treasury to the credit of the Teachers' Retirement Fund, which benefits the State Teachers' Retirement System (STRS). With the CSLC serving as trustee for the SLBF, a fiduciary relationship exists between the CSLC (trustee) and STRS (beneficiary), and obligates the CSLC to make school lands productive, primarily in financial terms, for the beneficiaries of STRS. This fiduciary responsibility includes protection of trust assets as well as the generation of revenue.

The CSLC's emphasis in administering the Program has been: 1) the 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 2002-03 was \$3,928,490.59, which represented an increase of 16% over FY 2001-02. Net revenue deposited to the SLBF was \$4,096,134.58, resulting in a fiscal year end balance of \$47,097,168.75. Management costs for the Program in FY 2002-03 were \$1,413,570.82, which represented an 11% decrease from FY 2001-02. For a summary, see the table entitled "Financial Summary: Fiscal Year 2002-03" (page 28).

The *Annual Staff Report on the Management of State School Lands* is prepared pursuant to PRC Section 6477. The major activities for each of the Program components for FY 2002-03 are described in the following pages.

SURFACE MANAGEMENT PROGRAM

The Land Management Divisions 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; issuance of leases for various purposes such as agricultural, grazing, and rights of way for roads, oil pipelines, gas pipelines, and electrical transmission lines. Activities also include the management of approximately 36,500 acres of commercially harvestable timberland. 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 2002-03" (page 8).

UPDATE: CALIFORNIA DESERT PROTECTION ACT OF 1994

On October 31, 1994, the California Desert Protection Act (CDPA) was signed into law by the President of the United States (Public Law 103-433). The CDPA designates 3.6 million acres in southern California as wilderness to be administered primarily by the Bureau of Land Management (BLM), and designates an additional 4 million acres in southern California to be included in the national park system.

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

Section 707 of the CDPA provides for the exchange of 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 four CDPA land exchange transactions completed with the BLM. In the first transaction, completed in September 1996, 5,646 acres of school lands were transferred to the BLM. The value of these lands, \$992,686, was deposited into the SLBF. In June 1997 a second transaction resulted in \$144,000 being deposited into the SLBF after 800 acres was transferred to the BLM. The third transaction, valued at \$13,155,120, was completed in November 1997 and involved 57,309 acres of school lands that were transferred to the BLM. In exchange, the CSLC acquired a 100-acre federal surplus parcel in Pomona and immediately sold the acquired land to the city of Pomona. While the previous two transactions were all cash, and resulted in deposits to the SLBF, the Pomona sale was accomplished by the CSLC carrying a note secured by a deed of trust. Principal reduction payments were made on the note and deposited to the SLBF while interest payments were transferred to the STRS Fund. A total of \$1,563,622.60 in interest was earned and credited to STRS before the note was paid off in December 2001. The fourth transaction resulted in the CSLC acquiring 658 acres of federal lands located within the Chocolate Mountains area of San Bernardino County. The lands were acquired with the intent of potentially generating revenue to STRS through gold mining activities. The CSLC has not yet compensated the BLM for the value of these lands.

As FY 2002-03 drew to a close, a fifth CDPA land exchange involving the CSLC, the BLM, and the Metropolitan Water District of Southern California (MWD) was nearing completion. Upon the close of escrow, which is anticipated to occur during the first half of FY 2003-04, 2,560 acres of school lands will be transferred to the BLM in consideration for cash payment of \$456,900.

During FY 2002-03, substantial work was completed on a sixth CDPA land exchange, which will entail school lands worth approximately \$8.5 million. This exchange is scheduled for completion in FY 2004-05.

Due to a complex review and revision by the Bureau of Land Management of the federal standards and guidelines involving federal lands transactions, progress on both the fifth and sixth proposed CDPA/CSLC land exchanges was slowed substantially during FY 2002-03. As a result of these review and revision activities, all transactions involving federal lands will now require review by the Department of the Interior in Washington, D.C. As a consequence, the time necessary to complete these exchanges has been extended.

At the close of the 2002-03 fiscal year, there were 330 parcels of school lands containing a total of approximately 188,000 acres within the designated national parks, monuments, preserves, and wilderness areas available to exchange with the BLM.

FISCAL YEAR 2002-03 ACTIVITIES

STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Total revenue deposited into the STRS Fund from surface management activities in FY 2002-03 was \$300,570.96. This money was generated from the following transactions:

Surface Rental Income and Revenues

Most of the 476,000 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 2002-03 from approximately 140 revenue-generating leases totaled \$279,471.96. General surface leasing involves ongoing activities, including processing new applications, re-issuing expired leases (where appropriate), processing lease assignments and amendments, conducting rent reviews, terminating old leases, and conducting other surface management activities. Income from Timber (Covelo Fire sale) generated \$20,828.22. Miscellaneous income provided an additional \$270.78.

SCHOOL LAND BANK FUND REVENUES

Principal revenue from four school lands transactions (described in the following four paragraphs) totaled \$3,179,026.63. The total accrued interest earned on the SLBF during FY 2002-03 was \$942,049.64. A total of \$4,096,134.58 in net revenue was generated to the SLBF during FY 2002-03.

Town of Apple Valley Land Sale (SA 5754)

Staff completed the sale of approximately 160 acres of school lands to the Town of Apple Valley in San Bernardino County. The town sought this property for development of a private regional distribution center that is designed to bring a large number of jobs and growth to the local economy. The sale netted \$243,102 to the SLBF.

City of Shasta Lake Land Sale (SA 5752)

The City of Shasta Lake made two principal reduction payments totaling \$35,024.63 on its loan from CSLC for the purchase of a school lands parcel that occurred in FY 1999-00.

Dyer Mountain Land Sale (SA 5759)

Staff concluded the sale of a 480-acre school lands parcel in Plumas County. The parcel is part of a four-season development that may include a ski resort. This sale resulted in a deposit of \$2,900,000 into the SLBF.

County of San Bernardino Land Sale (SA 5756)

The County of San Bernardino purchased a 1.27-acre parcel of school lands for a road-widening project. The issuance of the patent for this sale resulted in a deposit to the SLBF of \$900.

Accrued Interest on the SLBF

The total accrued interest earned on the SLBF during FY 2002-03 was \$942,049.64. Accrued interest earnings declined from the previous year due to the lower interest rates that resulted from the general downturn in economic conditions.

SCHOOL LAND BANK FUND INVESTMENTS AND OTHER ACTIVITIES

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

Agricultural Property Investment (W 25759)

In September 2001, pursuant to a contract awarded in July 2001, staff received a consultant's report entitled "Planning for Agricultural Land Investments in California". The report concluded that agricultural properties could be suitable investments for SLBF monies and developed a set of investment criteria that would minimize risk while maximizing long-term returns. The contract with the consultant, Agland Investment Services, Inc., was extended during FY 2002-03 to provide assistance to staff in the identification and selection of potential agricultural investments. Numerous properties were investigated during 2002-03, and staff expects to make several purchases of agricultural properties during 2003-04. For further details on the progress of investment in agricultural properties, see the discussion under "Fiscal Year 2003-04 Planned Activities, Potential Land Bank Fund Investments – Agricultural Properties" (page 13).

Barstow Property Development (W 25758)

One of the prime properties in the school lands portfolio is a 34± acre parcel located at the northwest corner of Avenue L and Interstate Highway 15 in Barstow, San Bernardino County. For further details on the progress of the Barstow property development, see the discussion under “Fiscal Year 2003-04 Planned Activities, Potential School Land Bank Fund Investments-Barstow Property Development” (page 13).

Ground Leasing Investment Feasibility Study (W 25774)

On March 25, 2002, pursuant to Commission authorization received in September 2001, staff awarded a contract to Wallace and Steichen, Inc. for completion of a study on the ground leasing market in California and to assist staff in determining whether ground leased property, or property suitable for ground leasing, would be an appropriate investment vehicle for SLBF monies. The final report was delivered to staff in April 2003. The report concluded that ground leasing could be a viable alternative for SLBF monies, and developed a set of recommendations to guide staff in the selection of appropriate properties for investment. Staff intends to pursue ground leasing opportunities during the coming fiscal year. For further details, see the discussion under “Fiscal Year 2003-2004 Planned Activities, Potential School Land Bank Fund Investments - Ground Leasing Investments” (page 14).

Update of Master School Lands Inventory

Due to budget and personnel constraints, the master school lands inventory has not been updated since 1993. At the end of FY 2002-03, staff began a comprehensive update of the school lands database. Completion of the update, which is anticipated for the first half of FY 2003-04, will consolidate the changes to the inventory that have occur due to the CDPA land sales and exchanges and will facilitate the ongoing management of the school lands.

SUMMARY OF REVENUE GENERATED FROM SURFACE MANAGEMENT PROGRAM: FISCAL YEAR 2002-03

STRS FUND

Surface Rentals:

Surface Rentals:	\$ 279,471.96
Timber	\$ 20,828.22
Miscellaneous Income	\$ 270.78
TOTAL GROSS REVENUE GENERATED TO STRS FUND:	\$ 300,570.96

SCHOOL LAND BANK FUND

Land Sales:

Town of Apple Valley Land Sale (SA 5754)	\$ 243,102.00
City of Shasta Lake (SA 5752) Principal Reduction Payment	\$ 35,024.63
Dyer Mountain Land Sale (SA 5757)	\$ 2,900,000.00
County of San Bernardino Land Sale (SA 5756)	\$ 900.00
Total:	\$ 3,179,026.63
 Accrued Interest on the School Land Bank Fund:	 \$ 942,049.64
TOTAL GROSS REVENUE GENERATED TO SCHOOL LAND BANK FUND:	\$ 4,121,076.27

FISCAL YEAR 2002-03 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.

Interest Income

Staff anticipates receiving income from interest on the promissory note secured by the deed of trust that the CSLC is holding for the City of Shasta Lake. The note has a current remaining principle of \$120,765 and is scheduled to be paid off by July 2006.

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 and result from inevitable losses from natural causes, such as fire, high winds, insect infestation and diseases. Because of the sporadic and irregular nature of these operations, the amount of any additional income from these sources during the coming fiscal year is impossible to predict.

POTENTIAL SCHOOL LAND BANK FUND REVENUES

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

CDPA/Bureau of Land Management Land Exchanges

Staff anticipates the land exchanges with the Bureau of Land Management (BLM) mandated by the California Desert Protection Act (CDPA) will continue for several more years. Staff will be working on the following CDPA exchanges in FY 2003-04:

Metropolitan Water District (W 24480/AD 384)

Staff anticipates completion of a three-party land exchange between the CSLC, BLM and the Metropolitan Water District of Southern California (MWD) in the first half of FY 2003-04. The CSLC is prepared to transfer title to four school lands parcels totaling 2,560 acres to the BLM in consideration for a cash payment from MWD. The parcels are located within federal wilderness areas. In return for this cash payment, MWD will receive title to federal lands to include in its aqueduct facility. Upon close of escrow, \$456,900 will be deposited into the SLBF.

Bureau of Land Management (W 24480/AD 407)

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 \$2,081,775. Additionally, the BLM has available, through the U.S. 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 actively 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 SBLF from this transaction.

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

The CSLC has been participating in a complex five-party land exchange involving the BLM, General Services Administration (GSA), National Aeronautics Space Administration (NASA), CSLC, and the City of Downey (City). As originally proposed, the CSLC was to take title to approximately 96 acres of federal surplus land (a former NASA site) located in Downey, in exchange for comparable value of school lands, in accordance with the CDPA. The City then was to purchase the acquired land from the CSLC pursuant to the School Land Bank Act. However, during FY 2002-03, the transaction was re-negotiated. Under the new sales agreement, the GSA will transfer the surplus lands directly to the City, thereby eliminating the CSLC from the chain of title and minimizing the CSLC's liability exposure. The CSLC's CDPA program will still benefit from the GSA's sale of the property because \$500,000 from the net proceeds of the sale will be credited to the SLBF for future exchanges. Staff will continue to work with the involved parties on consummating this transaction, which should close escrow in the first half of FY 2003-04.

44+ Parcel Exchange (W 24480 & W 40157.3)

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

Amargosa Canyon Land Exchange (W 25843)

To equalize a land exchange between the BLM, the National Park Service (NPS) and a private party who owns land within the Death Valley National Park, the BLM requested the CSLC to consider making available a school lands property located within the federal Amargosa Canyon Natural Area in Inyo County. The BLM wants to acquire the parcel because of its valuable habitat and highly valued recreational areas. For consideration, the CSLC will receive cash for the fair market value of the school lands parcel (\$256,000) from the private party as part of the exchange transaction. As a result of the exchange, the private party will receive title to federal land; the BLM will receive title to the school lands parcel to be administered as part of the Amargosa Canyon Natural Area; and the NPS will receive title to the private party's property within Death Valley National Park.

This project has been substantially delayed due to a complete review of BLM appraisal practices and land exchange procedures. Upon BLM's request, the CSLC staff will continue negotiations with the BLM, NPS, and private party on this transaction.

Metropolitan Water District Land Sale (SA 5755)

Metropolitan Water District of Southern California (MWD) made an application to acquire a 200-acre parcel of school lands near Chiriaco Summit in Riverside County. MWD proposes to include the parcel in its Hayfield Groundwater Storage Facility Project to store water from the Colorado River. The school lands parcel will act as a buffer to prevent contaminated groundwater from getting into the groundwater basin project area from the north. Staff will continue efforts to consummate this sale, which is valued at \$60,000.

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

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

United States Forest Service Land Exchange (W 23390)

On June 30, 1987, the CSLC authorized a Memorandum of Understanding between the CSLC and the Pacific Southwest Region of the U.S. Forest Service (USFS). The purpose of this agreement is to facilitate the exchange of CSLC lands located within national forest boundaries (inholdings) for forested lands outside of national forest boundaries. The proposal consolidates the respective inholdings and benefits both agencies. Phase 1 of the exchange, which included CSLC inholdings primarily in southern California, was completed in 1990. Phase 2 of the Exchange was delayed due to required federal cultural and archaeological studies. In Phase 2, the CSLC would exchange its remaining national forest inholdings for approximately 1,640 acres of land containing an estimated 55 million board feet of timber in Butte County.

POTENTIAL SCHOOL LAND BANK FUND INVESTMENTS

Staff has identified several property types as prime targets for the investment of SLBF monies. The properties include agricultural property investments, ground leasing of a commercial parcel in Barstow, San Bernardino County, and other ground leasing possibilities throughout California. In addition to these primary areas, other investment alternatives also will continue to be considered as possible investment avenues for SLBF monies.

Agricultural Properties

Incorporating the guidelines and property selection screening criteria developed in the report "Planning for Agricultural Land Investments in California", staff plans to continue analyzing available agricultural investment opportunities throughout California. Staff will prepare and circulate a Request For Proposal (RFP) for a Farmland Advisor/Manager to assist staff in obtaining and analyzing information on specific agricultural investments and assist staff in the purchase and long-term management of the properties. Staff anticipates awarding the contract for the consulting services in the second half of FY 2003-04, and with the assistance of the consultant, completing several investments of from \$1 million to \$5 million in California agricultural land during FY 2003-04.

Barstow Property Development

On September 28, 2001, pursuant to Commission authorization received in April 2001, CSLC staff circulated a Request for Proposal (RFP) to locate a consultant to study the feasibility of ground leasing an approximately 34-acre school lands property located at the northwesterly corner of Avenue L and Interstate Highway 15 in Barstow. A contract to complete the study was awarded to the firm Wallace and Steichen, Inc. on December 3, 2001. The consultant's final report, entitled "Feasibility Study for NWC Interstate 15 at Avenue L, Barstow, CA" was completed March 20, 2002. The report was very positive as to the prospects for a successful ground-leasing program for the property, and several development options were presented. Due to the large property size and the nearly twenty year forecast absorption period, it was determined that the best option was for the CSLC to act as master developer of the property (design an overall site plan, construct infrastructure improvements and lease individual pad sites). However, after consultations with members of the CSLC legal staff, it was determined that the CSLC's legal authority to expend Trust funds on infrastructure improvements was not clearly defined. Therefore Staff drafted new legislation to provide a legal framework that will formally authorize the expenditure of funds on capital improvements on the real estate that is under its management. Staff will be actively promoting the passage of the new legislation in the next session of the Legislature.

Ground Leasing Investments

In April 2003, pursuant to a CSLC consulting contract awarded in March 2002, staff received a report from Wallace & Steichen, Inc. entitled "Analysis of Ground Leases as an Investment Alternative". The report indicated that there are positive prospects for this type of investment. Staff proposes to continue pursuing the possibility of investing SLBF funds into long-term ground leases. Staff will research specific commercial, industrial, and/or retail land purchases where the resulting development would produce a stable, long-term income stream with low management expenses, relatively low risk, and the benefits of asset appreciation.

Update of Master School Lands Inventory

It is anticipated that staff will complete the update to the Master School Lands Inventory during the first half of FY 2003-04. The update will consolidate the changes to the inventory that have occurred due to the CDPA and other land sales and exchanges. The update will facilitate the efficient ongoing management of the school lands.

GEOHERMAL, SOLID MINERALS, AND OIL & GAS PROGRAMS

The Mineral Resources Management Division 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. 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 2002-03 ACTIVITIES

GEOHERMAL PROGRAM

The Geysers

There are 5,563 acres of school lands under lease at The Geysers geothermal steam field in Sonoma and Lake counties. The Geysers is the world's largest geothermal development, currently generating about 1,000 megawatts of electricity. About 25% of the generation is derived from State leases, with the balance derived from leases on Federal or private lands. Calpine Corporation, through its Geysers Power Company, LLC, and Silverado Geothermal Resources, Incorporated, subsidiaries, owns and operates most of the steam field and power generating facilities at The Geysers, and is the lessee of all eight of the State's active geothermal leases.

Royalty and net profit revenue during Fiscal Year (FY) 2002-03 from State leases at The Geysers totaled \$4,531,578.39. This represented a 14% increase from the total collected in FY 2001-02 and was due mainly to the release of \$721,376.81 in disputed royalties and associated interest related to production that occurred during 1990-1999.

Staff continued discussions with Calpine concerning new leasing, but no leases were issued. Calpine originally submitted an application covering a 743-acre parcel of reserved mineral interest school lands that it proposed to develop and use to supply an existing generating facility. Calpine later advised staff of its desire to amend the application to include additional school lands, and to combine the State lands with adjacent private lands as part of a development project that would involve up to four new generating facilities of approximately 25 megawatts each. Such a development would trigger the licensing process of the California Energy Commission (CEC), which would act as Lead Agency for the required environmental documentation under the California Environmental Quality Act (CEQA).

The City of Santa Rosa completed construction of the Santa Rosa Geysers Recharge Project (SRGRP), a 41-mile pipeline system to transport reclaimed wastewater from Santa Rosa to The Geysers. Calpine completed construction of a system of smaller pipelines to distribute the SRGRP water throughout The Geysers for injection. The injected water will enhance the productivity and extend the life of the steam field. The SRGRP is expected to begin operating in the later part of 2003. Staff continued to work with Calpine concerning the planned utilization of the injection water and approved the conversion of two idle producing wells to injection.

Geothermal Prospecting Permit Applications

Staff was able to make only limited progress on applications for geothermal prospecting permits submitted by Mack Energy Company and Layman Energy Associates for school lands parcels in the vicinity of Truckhaven near the western shore of the Salton Sea in Imperial County. Both applications remain incomplete pending the submittal of additional project description information and action on the part of the applicants to secure use permits from Imperial County's Planning Department. That department would be Lead Agency for an analysis of potential environmental impacts of exploration and development as required by the CEQA. The surface of some of the school lands involved are owned and utilized by the California Department of Parks and Recreation (DPR) as part of its Ocotillo Wells State Vehicular Recreation Area. Use of such lands for possible exploration and development of geothermal resources must not interfere with the use of the area for off-road recreation.

Staff began processing an application received from DeepRose, LLC, for a permit to conduct geological and geophysical surveys for geothermal resources on a school lands parcel several miles north of the Coso Hot Springs geothermal field in Inyo County. The application is incomplete and staff is waiting on the applicant to submit additional information.

SOLID MINERALS PROGRAM

Royalty revenue from the solid minerals program totaled \$300,665.14 during FY 2002-03, which represented a 16% decrease from the total collected in FY 2001-02. Included in the total was an \$85,949.26 adjustment for a prior year. There are six active State mineral extraction leases, and the lessees include Hanson Aggregates, Washington Group International (WGI), Sigma Stone, Protech Minerals, U.S. Borax, and Newmont Mining. The decrease in revenue was attributable mainly to curtailed production of aggregate on leases held by WGI and Sigma Stone. Additionally, there are two 1/16th reserved mineral interest agreements involving 1,768 acres of school lands, one with Granite Construction and one with Calspar.

Staff completed the processing of an application for a mineral extraction lease for precious metals with Newmont Mining and continued processing applications for new mineral leases with the U.S. Bureau of Reclamation (BOR) and Hi-Grade Materials, as well as a lease amendment with Hanson Aggregates. Staff continued negotiating a 1/16th mineral interest agreement with Jacobson Construction Company for aggregate and processing applications for mineral prospecting permits with Southern Clay Products, Jaxon Baker, and NDT Ventures. Staff began processing a lease application from Cima Cinders Company to extract volcanic cinders. Two older applications for mineral prospecting permits for Glamis Imperial remain incomplete. Staff also asserted a leasable mineral interest for school lands involved in a proposed mine expansion for rare earth elements at MolyCorps' Mountain Pass Mine in San Bernardino County (W 40646).

Through a partnership with a sister State agency in the Department of Conservation, Office of Mine Reclamation, a program to reclaim lands impacted by prior mineral exploration or development was implemented. After addressing biological and historical resources, two mines were successfully sealed. The Pacific Fluorite Mine was closed with a steel gate accessible only to bats following a survey that revealed their presence. The American Opal Mine was closed with new technology employing a foam plug.

Mineral Lease Management

Hanson Aggregates (Lease PRC 7301)

Extraction of rock, sand, and gravel continued on school lands leased to Nelson and Sloan Company. The lease is operated by Hanson Aggregates and is located northeast of San Diego. Royalty from this lease decreased about 18% to \$108,519.87. The processing of Hanson's application to extend, amend and transfer the lease from Nelson and Sloan to Hanson is pending the completion of a financial audit. Numerous lease provisions are anticipated to be modified, including minimum royalty, minimum production and financial assurances.

Washington Group International (Lease PRC 8272)

WGI completed most of its work on a large California Department of Transportation (Caltrans) project to resurface a portion of Interstate 40 between Ludlow and Needles. The State received \$80,410.01 during the year based on \$0.47 for each ton of rock, sand, and gravel minerals extracted from the leased land. Due to its rural locality, production is likely to be minimal pending further road construction work.

Sigma Stone (Lease PRC 8253)

No royalty payments were received during the year. Sigma's mining operation is located between Victorville and Barstow along the Interstate 15 corridor. The need for aggregate materials diminished as most of the construction work along the corridor has been completed. However, growth in this area will likely lead to renewed mining as permitted aggregate quarries are increasingly valuable.

Protech Minerals (Lease PRC 8322)

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

U.S. Borax (Lease PRC 736)

U.S. Borax is the lessee for the Gerstley Borate Mine, an underground mine operating in eastern Inyo County since the 1920's. The mine provides a unique blend of calcium and sodium borates. Due to changes in regulations of the U.S. Mine Safety and Health Administration, the mine was no longer in compliance and could not legally operate. In accordance with the Reclamation Plan approved by Inyo County, the mine openings were sealed and prior surface disturbance was reclaimed. U.S. Borax is consulting with engineering firms on the viability of reopening the mine as a small open pit. In the interim, U.S. Borax continues to pay a minimum annual royalty on 600 tons of production, which amounted to \$19,186.00 for the year.

Newmont Mining (Lease PRC 8039)

Following the successful completion of a complex exploratory drilling program, the CSLC issued a preferential mineral extraction lease to Newmont for precious metals at the Mesquite Gold Mine in Imperial County. The mine has been in operation since 1985, but is not currently producing due to precious metal prices that remain low. Newmont hopes an increase in gold prices will permit the development of the State's fee-owned school lands as part of a recently permitted mine expansion.

Mineral Lease Applications

Bureau of Reclamation (Application PRC 6735)

The Bureau of Reclamation (BOR) filed a mineral lease application in March 2000 to resume mining at the 90-acre Manchester Quarry in the Dead Mountains area of San Bernardino County near Laughlin, Nevada. Legal impediments involving the financial security instrument have precluded progress. The application involves BOR quarrying about 2.8 million tons of rip-rap rock over a 25-year lease period for riverbank stabilization along the Colorado River in California to protect life and property during periods of high water flow along the river. Staff continued working with the BOR, the San Bernardino County Planning Department, the State Office of Mine Reclamation and the Bureau of Land Management (BLM) to resolve the financial assurance requirement and other issues.

Hi-Grade Materials (Lease Application W 40842)

Hi-Grade applied for a negotiated mineral extraction lease for the enlargement of an existing sand and gravel extraction operation near Hesperia in San Bernardino County. The proposed project involves about 18 acres of school lands. The County has been working with Hi-Grade to resolve several engineering issues prior to consideration of Hi-Grade's continuation of a Conditional Use Permit (CUP). The CSLC would consider Hi-Grade's mineral lease application only after the County has issued the CUP and approved the Reclamation Plan. The County has advised staff that Hi-Grade may consider an amendment of its application to exclude the State lands.

Jacobson Construction (Application W 40783)

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

Cima Cinders Company (Lease Application W 40880)

Staff began processing an application submitted by Cima for a mineral lease to extract material from a volcanic cinder deposit located within the CDPA area. The parent company extracted cinders from the same school lands parcel in the early 1950's and developed cinder block markets in the Las Vegas, Nevada area and provided road-surfacing materials for local county roads and State Highways. Cima also maintains mining claims on adjacent Federal lands containing cinder deposits.

Mineral Prospecting Permits and Applications

Interest in prospecting for precious and base metals from school lands remained limited. Management policies and laws on Federal lands have reduced the availability of areas open to mineral exploration and development, particularly in the desert areas of California, including the area of the CDPA. However, staff anticipates increased future demand for permits to explore and develop sand and gravel deposits, primarily to serve the road maintenance and development needs of Caltrans and the local counties.

Glamis Imperial (Applications W 40588, W 40589)

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

Jaxon Baker (Applications W 40882, W 40883, W 40884)

Staff began processing three applications from Jaxon Baker for mineral prospecting permits to conduct limited sampling of sand and gravel from established roads near Highway 395 in Inyo County near Lone Pine. If found to have appropriate physical and chemical qualities, the aggregate would likely be used for local county roads and by Caltrans for State Highway maintenance and expansion.

Southern Clay Products (Application W 40851)

A mineral prospecting permit application submitted by Southern Clay remains incomplete. The proposed permit area is east of Death Valley in Inyo County near the Nevada border. Valuable clay minerals are mined in the same area. Southern Clay proposes exploration to determine if a clay resource underlies the school lands parcel and if it can be developed economically. Staff continued to work with the County and Southern Clay on the permitting process for this project.

NDT Ventures (Application W 40870)

A mineral prospecting permit application for precious metals was received from NDT Ventures in July 2002 to prospect a mineralized region approximately 10 miles north of Bodie in Mono County. The parcel was the site of an earlier mineral prospecting permit that revealed the presence of precious metals. The application remains incomplete pending receipt of further information.

Mineral Evaluations for the California Desert Protection Act (CDPA)

Staff used readily available technical information to review and assign mineral potential to those school lands parcels remaining after the past release of 265 parcels assessed for low mineral potential. Of the remaining parcels, 99 possess moderate potential, and 73 possess high potential. Staff continued its efforts to negotiate exchanges for similar Federal mineral lands in other areas of California without comprehensive, time-consuming, and expensive field evaluations. This approach both supports the environmental mandate of the CDPA and maintains or maximizes the future income-generating potential of mineral lands through acquisition of market-sensitive mineral properties. Particular focus has been applied to identifying, analyzing and marketing aggregate-bearing school lands, which could help meet the ever-growing concrete and asphalt demands of Caltrans in maintaining and expanding the State's Highway system. Staff continued to assemble regional highway-based portfolios of high potential sand and gravel parcels for possible mineral exploration and development to maximize STRS revenues and to minimize Caltrans construction costs.

OIL & GAS PROGRAM

Royalty revenue from the two existing school lands oil & gas agreements totaled \$250,688.93, which is a 31% increase over the prior year. Oil production from the two school lands parcels actually decreased by about 9%, but the average per barrel price of that oil increased by more than 37% from the prior year. The higher average price reflects the higher price of crude oil worldwide.

Round Mountain (Agreement 5310)

This 160-acre school lands parcel in the Round Mountain oil field northeast of Bakersfield in Kern County produced more than 99% of the total oil & gas royalty revenue. The parcel is part of a 2,363-acre unit organized in 1994 and operated by MacPherson Oil Company.

Sulfur Crest (Agreement 9252)

This seven-acre school lands parcel in the Sulfur Crest area of the Santa Paula oil field in Ventura County produced the balance of the revenue totaling approximately \$500.

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



SUMMARY OF REVENUE GENERATED FROM GEOTHERMAL, SOLID MINERALS, AND OIL & GAS PROGRAMS: FISCAL YEAR 2002-03

STRS FUND

Geothermal Royalties and Net Profits:

Royalties from leases at The Geysers:	\$ 3,079,914.77
Adjustment	\$ 721,376.81
Net Profits from lease at The Geysers:	\$ 730,286.81
Geothermal Total:	\$ 4,531,578.39

Solid Minerals Royalties:

Royalties from leases and 1/16th agreements:	\$ 214,715.88
Adjustment	\$ 85,949.26
Solid Minerals Total:	\$ 300,665.14

Oil & Gas Royalties:

Total from leases in Kern and Ventura Counties:	\$ 250,688.93
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TOTAL GROSS REVENUE GENERATED TO STRS FUND: \$ 5,082,932.46

FISCAL YEAR 2003-04 PLANNED ACTIVITIES

GEOHERMAL PROGRAM

The Geysers

Staff estimates the State's royalty and net profit revenue from its school lands geothermal leases at The Geysers will reach \$3.8 million in FY 2003-04. This is slightly less than in FY 2002-03 because the prior year included some disputed royalty from steam production that occurred several years ago. Steam production and steam prices are expected to remain fairly stable.

To maximize the State's future royalty revenue, staff plans to continue working on the following goals: (1) develop school lands already under lease but not fully developed; (2) negotiate terms for the leasing and development of unleased school lands; (3) improve the utilization of available steam resources through optimization of steam field and power generating facility operations; and (4) select well conversion candidates for optimal injection benefits related to the SRGRP injection water. Staff will continue to monitor all production operations and engineering projects on State leases and adjacent lands, verify all pricing and royalty calculations, and look for new opportunities to increase royalty revenue from school lands at The Geysers.

Geothermal Permit Applications

Staff will continue working with its two applicants for geothermal prospecting permits, and work with the DPR and Imperial County to coordinate the permitting of exploration activities in the vicinity of Truckhaven on the west side of the Salton Sea. Staff will also work with any other applicant for a geothermal permit, including the one involving school lands in the Coso region of Inyo County.

SOLID MINERALS PROGRAM

Mineral Lease Management

Revenue from solid minerals leasing is expected to remain near its current level during FY 2003-04. An increase could occur from leases coming into full production, the amendment of an existing lease and a new 1/16th agreement. Additional royalties are possible if some of the mineral prospecting permits mature into leases.

Staff anticipates approval of the amendment, extension, and transfer of Hanson's mineral lease in San Diego County. The amendment should provide for a doubling of revenue as a result of a higher royalty rate and higher minimum annual production, but the revenue would not be expected before FY 2004-05.

A 1/16th mineral agreement is likely to be concluded with Jacobson Construction for an aggregate project near Baker. Such an agreement may provide upwards of \$100,000 per year in mineral royalty due to construction and maintenance work on adjacent Interstate 15.

Staff plans to continue efforts to resolve issues related to the re-issuance of a mineral extraction lease to the BOR for the excavation of rip-rap rock in San Bernardino County. Staff anticipates resolution of the financial assurance issue soon. Permitting will likely be completed in the first half of FY 2004/2005. Potential revenue over the 25 year life of the lease could exceed \$3 million, making it a prominent income stream for the solid minerals program.

Staff plans to conclude negotiations with Kaiser Resources to exchange approximately 467 acres of reserved mineral interest lands for a percentage interest in a mineral estate owned by Kaiser at its inactive Eagle Mountain Mine in Riverside County. The existing property is within the confines of a large open pit area that was mined for iron ore for over 30 years. Kaiser has permitted a landfill at the site, and plans to sell the property to the Los Angeles County Sanitation District. Since future iron ore mining is unlikely, staff is negotiating to obtain other mineral property with equal or higher mineral development potential.

Pending confirmation of Department of Conservation funding, staff plans to identify and close additional mine openings that may present a hazard to the public or wildlife.

Mineral Prospecting Permits

Staff anticipates the CSLC will consider the issuance of prospecting permits to Southern Clay and Jaxon Baker in Inyo County and NDT Ventures in Mono County. Staff expects additional prospecting permits will be issued by the CSLC as Caltrans' sand and gravel needs are further defined.

Mineral Inquiries

Staff will continue to investigate and respond to inquiries it receives concerning the availability of school lands parcels for solid minerals prospecting or leasing.

California Desert Protection Act (CDPA) Land Exchanges

All 440 fee-owned CDPA school lands parcels have been assessed for mineral potential, and 265 have been released for sale at the appraised value of the surface. The remaining parcels have moderate or high mineral potential and are subject to further analysis and valuation prior to exchange or sale. Staff has repeatedly attempted to meet with BLM regarding exchange of these lands for similar Federal mineral lands in other regions. Staff anticipates amendment of two Memoranda of Agreements (MOA) with the BLM. The BLM would also like to renegotiate a proposed exchange of 44 BLM tracts located in the San Joaquin Valley that possess oil & gas potential. Staff would also like to amend the MOA involving valuation of minerals on CDPA school lands parcels in a manner that will be consistent with existing directives and guidelines of the State Surface Mining and Reclamation Act.

OIL & GAS PROGRAM

Royalty revenue from the two school lands oil and gas leases is expected to remain at about \$250,000 during FY 2003-04. This assumes production rates and crude oil prices do not change substantially.

FINANCIAL SUMMARY: FISCAL YEAR 2002-03

STRS FUND

REVENUES AND EXPENSES

Revenues:

Surface Rentals	\$	279,471.96
Timber.....	\$	20,828.22
Miscellaneous Income	\$	270.78
Geothermal	\$	4,531,578.39
Minerals	\$	300,665.14
Oil and Gas.....	\$	250,688.93
GROSS REVENUES	\$	5,383,503.42
Less: Geothermal Resource Development Account (GRDA) Deposits.....	\$	<41,442.01>
(Public Resources Code Section 3826)		
TOTAL	\$	5,342,061.41

EXPENSES: Net Management Costs

Land Management.....	\$	590,380.07
Geothermal	\$	307,821.48
Minerals	\$	570,571.28
Oil and Gas.....	\$	102,263.50
Ownership Determination	\$	50,138.17
GROSS EXPENSES	\$	1,621,174.50
Less: Reimbursement Recovery	\$	<207,603.68>
TOTAL EXPENSES	\$	1,413,570.82

NET REVENUE TO STRS \$ **3,928,490.59**

SCHOOL LAND BANK FUND

Balance as of July 1, 2002.....	\$	43,001,034.17
SMIF Interest Earned Fiscal Year 2002-03.....	\$	942,049.64
Revenue from Land Sales	\$	3,179,026.63
Accounting Adjustments – FY 2001-02.....	\$	10,032.11
Less: Contracts for Investment Services.....	\$	<34,973.80>
BALANCE OF SLBF AS OF JUNE 30, 2003	\$	47,097,168.75

LIST OF ABBREVIATIONS

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