

CALIFORNIA STATE LANDS COMMISSION

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

Fiscal Year 2006-07

CALIFORNIA STATE LANDS COMMISSION

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Submitted to:

Honorable Arnold Schwarzenegger, 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 469,000 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 previously has been sold. Management of the Program is split between two CSLC divisions, the Land Management Division (LMD) and the Mineral Resources Management Division (MRMD). The LMD is responsible for the Surface Management Program under which all surface resources on school lands, with the exception of mineral activities, are administered. The MRMD is responsible for the Geothermal, Mineral, and Oil & Gas Programs, which involve the leasing of school lands for geothermal resources development, mining activities, and oil and gas development.

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

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

The CSLC's emphasis in administering the Program has been: 1) the maximization of revenues from school lands assets, 2) the continued implementation of the California Desert Protection Act Exchange Program, and 3) protecting the corpus of the trust. Net revenue transferred to STRS during Fiscal Year 2006-07 was \$5,716,522.17, which represents an increase of 5.09% over the prior year net revenue. Management expenses for the Program in FY 2006-07 totaled \$933,613.52, which represents a 1.82% increase from FY 2005-06 expenses. Net revenue deposited to the SLBF was \$2,655,982.97, resulting in a fiscal year end balance of \$57,102,504. For a summary, see the table entitled "Financial Summary: Fiscal Year 2006-07" (page 26).

The *Annual Staff Report on the Management of State School Lands* is prepared pursuant to PRC Section 6477. The major activities for each of the Program components for FY 2006-07 are described in the following pages.

SURFACE MANAGEMENT PROGRAM

The Land Management Division is responsible for the Surface Management Program, which oversees all surface activities on school lands with the exception of mineral activities. These activities include land exchanges and sales of school lands parcels to public and private entities, acquisitions of lands to enhance the resource base, and issuance of leases for various purposes such as agricultural, grazing, and rights of way for roads, oil and gas pipelines, and electrical transmission lines. The objectives of the Program are to manage surface uses to generate revenue, assure ongoing viability of the resource, protect the corpus of the trust, enhance local economies, and protect the environment. These goals are accomplished through management and development techniques that maximize the economic return to STRS and the SLBF. For a summary of the revenues generated to STRS and the SLBF through this Program, see the table entitled "Summary of Revenue Generated From Surface Management Program: Fiscal Year 2006-07" (page 6).

FISCAL YEAR 2006-07 ACTIVITIES

STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Surface Rental Income and Revenues

Most of the 469,000± 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. Total revenue deposited into the STRS fund from approximately 140 revenue-generating leases in FY 2006-07 totaled \$143,745.90. General surface leasing involves ongoing activities, including processing new applications, re-issuing expired leases, processing lease assignments and amendments, conducting rent reviews, terminating old leases, and conducting other surface management activities.

SCHOOL LAND BANK FUND REVENUES AND EXPENSES

Accrued Interest on the School Land Bank Fund

The total accrued interest earned on the SLBF during FY 2006-07 was \$2,827,546.11. Accrued interest earnings increased 44% from the previous year due to the higher account balance and the higher interest rates that resulted from a general upturn in economic conditions. Since there were no sales of school lands during FY 2006-07, the entire increase in the balance of the SLBF was attributable to interest income.

Expenses Charged to the School Land Bank Fund

Expenses charged to the SLBF during FY 2006-07 totaled \$171,563.14. The majority of these expenses (97%) were attributable to an abandoned mine closure program mandated by the Legislature (See Abandoned Mine Lands, pages 18 and 24). The remainder of the expenses accrued pursuant to the preparation of a report on unfunded liabilities on school lands, also mandated by the Legislature. (see Potential Hazards on School Lands, page 9)

UPDATE: CALIFORNIA DESERT PROTECTION ACT OF 1994

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

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

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

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

During FY 2006-07, work continued on a sixth CDPA land exchange. Staff completed a review of an appraisal on 107 parcels of school lands prepared by an independent appraiser for the Department of the Interior's Appraisal Services Directorate (ASD). The review concluded that the appraisal was inadequate and unacceptable. Staff subsequently entered into negotiations with the ASD in an attempt to reach an acceptable estimate of market value for the subject properties. These negotiations resulted in the conclusion that a second appraisal would be required and that the CSLC would need to contract for its own appraisal of the subject properties. It is not expected that the sixth CDPA land exchange will be completed until FY 2008-09.

At the close of FY 2006-07, there were 326 parcels of school lands containing a total of approximately 185,400 acres within the designated national parks, monuments, preserves, and wilderness areas available to exchange with the BLM.

**SUMMARY OF REVENUE GENERATED FROM SURFACE
MANAGEMENT PROGRAM - FISCAL YEAR 2006-07**

STRS FUND

Surface Rentals:

Surface Rentals:	\$ 143,745.90
TOTAL GROSS REVENUE GENERATED TO STRS FUND:	\$ 143,745.90

SCHOOL LAND BANK FUND

GROSS REVENUE GENERATED TO SCHOOL LAND BANK FUND:	\$ 2,827,546.11
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EXPENSES

Program 10 – Abandoned Mine Closure Program:	\$ 166,968.07
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Program 20 – Unfunded Liabilities Report:	\$ 4,412.20
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Miscellaneous Charges:	<u>\$ 182.87</u>
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TOTAL EXPENSES CHARGED TO SCHOOL LAND BANK FUND:	\$ 171,563.14
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NET REVENUE GENERATED TO SCHOOL LAND BANK FUND:	\$ 2,655,982.97
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FISCAL YEAR 2007-08 PLANNED ACTIVITIES

POTENTIAL STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Surface Rentals Income

Revenue will continue to be generated from existing surface use leases and new leases (when appropriate) on school lands parcels. Staff also expects to receive new revenues from the ground leasing of two parcels of school lands in Barstow, San Bernardino County. In December 2005, staff completed the sale of 13.7 acres of prime commercial land at the intersection of I-15 and L Street in Barstow to Home Depot, U.S.A., Inc. In addition to a cash payment, the terms of the sale required Home Depot to install infrastructure improvements (curbs, gutters, sidewalks, utility service, etc.) to service the remaining two parcels that were retained by the CSLC. Because of staff's management, approximately 19 acres of prime commercially zoned land now is available for long-term ground leasing. In January 2007, staff received applications from a prominent commercial real estate developer to lease the two parcels. Staff anticipates that the commercial ground leases will be negotiated and finalized in FY 2007-08.

Income from Timber Harvests

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

POTENTIAL SCHOOL LAND BANK FUND REVENUES AND ACTIVITIES

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

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

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

terms of the original CDPA legislation. When completed as proposed, it is anticipated that approximately \$6,500,000 will be deposited into the SLBF from this transaction.

Mendocino County Land Exchange (W 26045/AD 528)

Early in 2005, staff received an application from White Cloud Resources (White Cloud) that proposed a land exchange involving a 167-acre parcel of school land located northeast of Covelo in Mendocino County. Under the terms of the proposed exchange, the CSLC would transfer fee title to the parcel to White Cloud and White Cloud would transfer fee title a 114-acre parcel of nearby land that borders other CSLC property to the CSLC. The CSLC would benefit from the exchange because it would consolidate the CSLC's merchantable timber holdings into a more manageable tract. Because the appraised fair market value of the CSLC property exceeds the fair market value of the exchange property, the CSLC also will receive a \$225,000 cash payment from White Cloud. This cash payment will be deposited into the SLBF upon the completion of this transaction. Late in FY 2006-07, staff completed surveys of the properties involved in the exchange. Staff expects to complete this land exchange in FY 2007-08.¹

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

Staff has received an application from the Bureau of Indian Affairs (BIA) to purchase approximately 27 acres of school lands in Modoc County. The property is required as part of a complex project to replace Lauer Dam, a federally-owned dam that has been determined to be at a "high risk" for possible failure. Staff completed a survey of the project and appraisal on the property in FY 2006-07, and expects this sale to close late in 2007. Proceeds from this sale (\$8,150) will be deposited into the SLBF.²

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

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

¹ This land exchange was approved by the Commission at its meeting of October 30, 2007 and is in the process of being finalized as this report goes to press.

² This land sale was approved by the Commission at its meeting of September 13, 2007 and is in the process of being finalized as this report goes to press.

Sallis Land Sale (SA 5764)

In December 2006, staff received an application from Robert D. Sallis and Cheryl K. Sallis to purchase approximately 17,030 square feet of school lands located in Needles. An independent appraisal was completed and approved by staff and a survey of the property was performed. As FY 2006-07 was drawing to a close, the Sales Contract for this sale was being finalized. Staff expects this sale to close early in FY 2007-08, which will result in the deposit of \$22,000 into the SLBF.³

New Investments – Agricultural Land and Ground Leases

During FY 2006-07, staff will continue to research potential new investments for SLBF monies. Staff will concentrate on agricultural lands and ground leases that maximize potential revenues while minimizing management expenses. Staff also will work with the STRS real estate staff to explore methods for utilizing the expertise and resources of a larger investment fund with mutual investment goals. During 2007, staff also requested the authorization of a new staff position dedicated to the acquisition of new investment properties for the SLBF, and hopes to receive this new position beginning July 1, 2008.

Potential Hazards on School Lands

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

³ This land sale was approved by the Commission at its meeting of September 13, 2007 and is in the process of being finalized as this report goes to press.

Alternative Energy Projects

With the rise in energy prices and increasing public awareness about global warming, staff has received increasing interest concerning the long-term leasing of school lands for alternative energy projects. Most of these projects involve the utilization of wind power as an energy source. The projects require the installation and operation of wind turbines (also known as “wind farms”) that produce electricity which then can be delivering into the state’s electrical energy grid system.

To date, two wind energy lease applications have been received. These projects, located in Kern and San Diego counties, currently are involved in the development of plans that will satisfy the provisions of California Environmental Quality Act. Staff also has received inquiries regarding the availability of school lands in San Bernardino and Imperial counties for wind energy projects, but so far no lease applications have been received on these properties.

GEOTHERMAL, SOLID MINERALS, AND OIL & GAS PROGRAMS

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

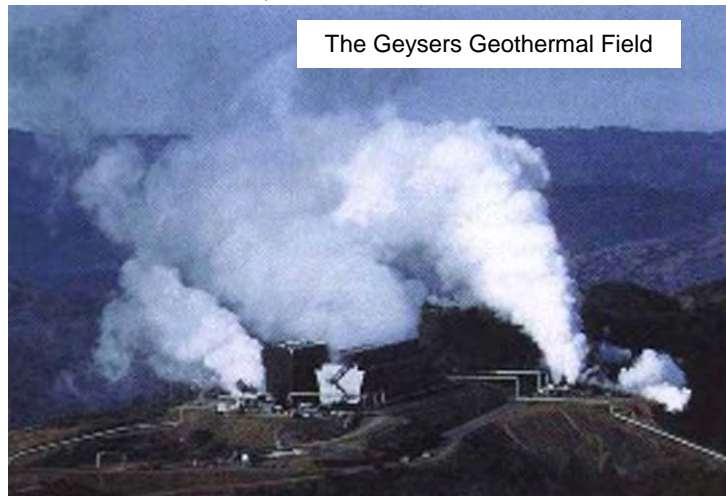
FISCAL YEAR 2006-07 ACTIVITIES

GEOTHERMAL PROGRAM

Revenue from the geothermal program totaled \$5,551,291.26 for FY 2006-07, a 1% increase from the total for FY 2005-06. All the revenue is from The Geysers geothermal field. Steam production from the leases at The Geysers decreased by roughly 1% from the prior year. However, the value of the steam increased by roughly 2%, reflecting slightly higher prices for the electricity generated from the steam.

Geothermal Leases at The Geysers

The Geysers field in Sonoma and Lake counties is the site of the world's largest geothermal development. The State now has 6,862 acres of 100% reserved mineral interest school lands under lease, plus another 360 acres of 1/16th reserved mineral interest school lands that are productive. The State acreage provides about 25% of the steam used to generate nearly 1,000 megawatts of electricity. The balance of the steam is produced from Federal and private leases.



Geysers Power Co. LLC (GPC) owns and operates most of the steam field and the generating facilities, and is the lessee of all seven of the State's geothermal leases. GPC is one of nearly 200 subsidiaries owned by Calpine Corporation that filed for protection under Chapter 11 of the Bankruptcy Code in December 2005. However, during the restructuring process, GPC continued its geothermal operations with no curtailment of steam production or generation of electricity,

and has continued to pay all royalties due under the terms of its State geothermal leases. Calpine Corporation, GPC and related debtors have filed a reorganization plan in the Chapter 11 proceeding and anticipate emerging from the bankruptcy as a reorganized debtor within the next several months.

In August 2006, the CSLC approved an amendment granting Geysers Power Co. authorization to develop portions of a 1,881-acre lease issued by the CSLC in 2004. The development plan included drilling several new wells on the lease and constructing a new pipeline system to transport steam to its existing power generating facilities. However, in June 2007, Geysers Power Co. submitted a request to defer the drilling obligation as it evaluates the feasibility of constructing one or more new power generating facilities.

In October 2006, Geysers Power Co. submitted an application for a negotiated lease on 400 acres of reserved mineral interest school lands in the same part of the field as the 1,881-acre lease. The application was deemed complete in December 2006, and staff began negotiating lease terms with Geysers Power Co. A recommendation will be considered by the CSLC in FY 2007-08.

In June 2007, the CSLC approved an amendment modifying the steam pricing and net profit provisions of a 130-acre lease originally issued in 1976. Steam from the lease is now valued in the same manner as steam from the State's other leases, as a percentage of the value of the electricity generated from the steam. The net profit provision was replaced with a supplemental royalty that will equal or exceed the net profits share calculated under the previous accounting procedure. The simpler calculation will benefit Geysers Power Co. and the State by reducing the time and effort the parties would otherwise expend in preparing and analyzing net profit statements.

Staff approved the conversion of three wells to injection during the year as part of Geysers Power Co.'s on-going efforts to enhance steam productivity and extend field life through water injection. Water is obtained from condensed steam, local creeks, and from two large pipelines. One pipeline originates in Lake County, the other in the city of Santa Rosa. The two lines carry a total of 20 million gallons of reclaimed wastewater to The Geysers each day. A system of smaller pipelines distributes the water to injection wells throughout the field. Geysers Power Co. continues to see measurable increases in steam production rates as a result of the injection, as well as increases in generation efficiency from the improvements in steam chemistry associated with the injection.

Geothermal Prospecting Permit

Deep Rose LLC holds a geothermal prospecting permit on a 640-acre school lands parcel in Inyo County several miles north of the Coso geothermal field. The permit, issued by the CSLC in April 2006, gives Deep Rose an exclusive right to prospect for geothermal resources for two years, subject to a two-year

extension. The permit also includes a preferential right to a geothermal lease upon discovery of geothermal resources in commercial quantities. Deep Rose plans to drill an exploratory well that would be one of the deepest geothermal wells ever drilled in the U.S. During the year, Deep Rose increased its efforts to secure financing and find a suitable drilling contractor for the well.

Geothermal Prospecting Permit Applications

In May 2007, staff received three new applications for geothermal prospecting permits covering 4,485 acres of school lands north of the developed portion of The Geysers. The applications were submitted by three subsidiaries created by U.S. Renewables Group, a company that owns and plans to restart an idle geothermal power plant at The Geysers. However, the applications are being held in abeyance while staff thoroughly examines the suitability of offering the lands for lease by competitive public bid. Federal lands in the same part of The Geysers will be offered for competitive leasing by the BLM in the Fall of 2007.

Two other applications for geothermal prospecting permits remain incomplete. The applications cover 3,034 acres of school lands west of the Salton Sea in Imperial County in an area known as Truckhaven. The applications were submitted in 2001 by Mack Energy Co. and Layman Energy Associates. During the past six years, staff has repeatedly advised the applicants of the need to apply to Imperial County for a conditional use permit, but neither applicant has initiated that process. The County would be the Lead Agency for the required environmental analysis for one or more exploratory geothermal wells. Given the lack of diligence on the part of these applicants, staff plans to seek CSLC approval to terminate the applications and pursue a competitive bid lease sale (see discussion in following section).

Nomination for Competitive Bid Lease Sale

In January 2007, Ormat Nevada, Inc., submitted to staff a formal nomination covering 2,394 acres of school lands that it proposes be offered for leasing by competitive public bid in the Truckhaven area of Imperial County. The nomination covers most of the lands in the two applications discussed above. Staff intends to recommend that an additional 1,240 acres of school lands be added to those nominated by Ormat, for a total of 3,634 acres to be offered for leasing. In February 2007, the BLM released a programmatic Environmental Impact Statement (EIS) for the leasing and development of 14,731 acres of federal lands in the Truckhaven area. The scope of the EIS covers a 40,320-acre area that includes federal, state, and



private parcels interspersed in a checkerboard pattern. The BLM intends to issue non-competitive leases on some lands and hold a competitive bid lease sale on others. Staff has been working with the BLM to improve the chances that the federal EIS can be utilized as an equivalent environmental document under the state CEQA, so the CSLC can conduct its own competitive bid lease sale in the Truckhaven area. Ormat has agreed to provide funding to cover the environmental review and staff time related to conducting a competitive lease sale involving State lands. Staff has also been coordinating with the California Department of Parks and Recreation (CDPR), as most of the Truckhaven geothermal area is within the boundaries of CDPR's Ocotillo Wells State Vehicular Recreation Area.

SOLID MINERALS PROGRAM

Revenue from the solid minerals program totaled \$609,453.51 for FY 2006-07, a record high, which represented a 129% increase from FY 2005-06. The increase was primarily a result of the resumption of production at Hanson Aggregate's lease in San Diego County. The solid minerals program currently manages six active mineral extraction leases totaling 1,188 acres, and one active 1/16th reserved mineral interest agreement totaling 560 acres. In addition to overseeing these mineral properties, staff continued processing applications for three new mineral extraction leases on school lands parcels.

Mineral Lease Management

U.S. Borax (PRC 736)

U.S. Borax, Inc., (USB) submitted a quitclaim deed in February 2007 for its 160-acre lease at the Gerstley mine near the town of Shoshone, southeast of Death Valley in eastern Inyo County. The lease was one of the first solid mineral leases issued by the State, dating back to the 1920s.

Prior to submitting the quitclaim, USB paid a royalty of \$66,436.40 for an inventory of stockpiled borate ore. Operations at the underground mine were idled several years ago when it no longer met mine safety standards. All mine openings were sealed in 2005 for public safety, and two bat-compatible gates and an air shaft were installed. An inspection of the mine should verify compliance with applicable reclamation requirements. Staff is working with Inyo County Planning Department, the State Office of Mine Reclamation, and USB to ensure that all environmental and reclamation requirements are satisfied prior to the CSLC's formal acceptance of the quitclaim.



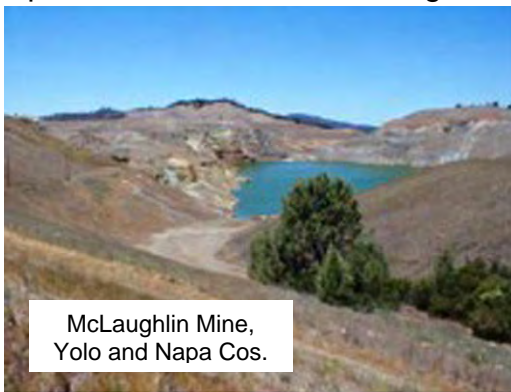
Hanson Aggregates (PRC 7301)

Hanson Aggregates (Hanson) resumed operations to extract sand, gravel, and rock from its 120-acre lease near Lakeside in San Diego County. Revenue from the lease is the highest ever, totaling \$260,885.24 for the year. The increased production is due to demand from the still-growing San Diego County region.



Homestake Mining (PRC 7808)

In 1994, amidst an ownership dispute, the CSLC issued Homestake Mining Company (Homestake) a 305-acre lease in Yolo and Napa counties within Homestake's 10,000-acre McLaughlin Gold Mine. The federal Board of Land Appeals subsequently ruled in favor of the State in that dispute. Homestake explored the leased land through a series of shallow drill holes adjacent to its

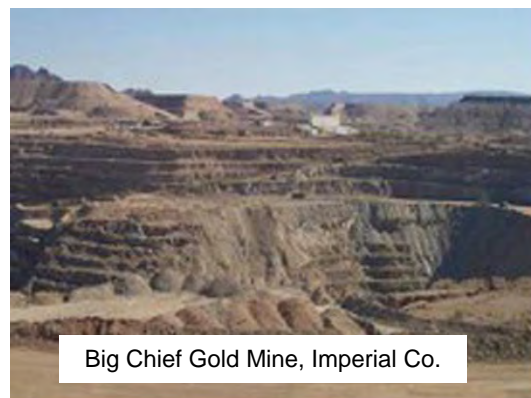


active gold mine, but did not discover economic mineralization. However, Homestake used the property to stockpile low-grade gold ore, which was later removed and processed when the mine closed a few years ago. In June 2007, staff inspected the site to evaluate reclamation work in preparation for the CSLC's formal acceptance of a Quitclaim Deed. Staff has requested verification letters from the SMARA lead agencies,

Yolo and Napa counties, as well as the Regional Water Quality Control Board that reclamation is complete. Following completion of all reclamation on the State lease, staff will prepare a recommendation to the CSLC to consider accepting the Quitclaim deed.

Western Mesquite Mines (PRC 8039)

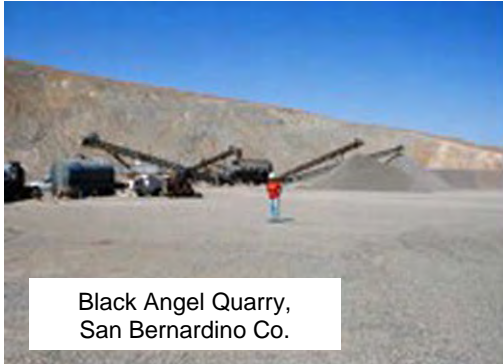
Western Mesquite Mines, Inc. (Western Mesquite) holds a 658-acre lease north of the Big Chief Pit in a remote area of Imperial County. Most of its mine property is located on BLM land and private property. Mining operations ceased in 2001 due to low gold prices and the depletion of resources available under the existing permits. Since then, gold prices have more than doubled to



over \$700 per ounce. Imperial County approved a mine expansion plan that includes the extraction of gold ore from the State lease. Western Mesquite announced its intention to resume production, but it first needs to invest in some new mining equipment. The revised mine plan calls for mining to begin on the State lease in 2011.

Sigma Stone (PRC 8253)

Sigma Stone Co. (Sigma) operates the Black Angel Quarry on a 160-acre State lease in a remote desert site several miles southwest of Barstow in San



Black Angel Quarry,
San Bernardino Co.

Bernardino County. Sigma extracts, crushes, and screens volcanic rock to produce gravel that it sells for road construction and other uses. Revenue from the lease increased to \$198,259.08 for the year due to high demand for aggregate. Production would have been even higher, but the quarry was vandalized and electrical cable was stolen.

Replacement of the lost equipment was expensive and resulted in nearly one month of downtime.

Protech Minerals (PRC 8322)

Protech Minerals, Inc. (Protech) holds a ten-acre lease at the Pioneer Talc Mine located in the Kingston Mountains in northeastern San Bernardino County. The resource consists of a natural deposit of the mineral talc. The mine remained idle during the year, but operations should be reactivated when the domestic market for talc improves. A total of \$6,600 was received for this year's and last year's minimum royalty payment.



Pioneer Talc Mine, San Bernardino Co.

Granite Construction, Ludlow Pit (PRC 8272)

Granite Construction Co. (Granite) holds an 80-acre lease near the community of Ludlow in San Bernardino County, which it acquired from Washington Group International in 2005. The sand and gravel mine is located near Interstate 40 making it ideal as a source of raw materials for repaving work. The mine is currently idle, but operations will



Ludlow Pit, San Bernardino Co.

resume as soon as Granite receives new contracts for road construction and maintenance. A minimum royalty of \$16,500 was received for the lease.

Granite Construction, Palm Desert Pit (PRC 7945)

Granite extracts sand and gravel from a large open pit mine near Palm Desert in Riverside County, which includes a 560-acre parcel where the State owns a 1/16th reserved mineral interest. The State's royalty is \$0.04 per ton of material mined. Revenue from the parcel totaled \$60,772.79 for the year.

Jacobson Construction (W 40783)

Jacobson Construction (Jacobson) mines sand and gravel in an area west of the community of Baker in San Bernardino County. The current mining operations are adjacent to a parcel of which the State owns a 1/16th reserved mineral interest. Staff continues to monitor Jacobson's operation regarding mining occurring next to the state parcel.



Mineral Prospecting Permits

Southern Clay Products (PRC 8571)

Southern Clay Products (SCP) held a two-year mineral prospecting permit on a parcel in Amargosa Valley, a remote area of Inyo County east of Death Valley. SCP owns the surface of the parcel, but the subsurface minerals are owned by the State. The permit expired in October 2006 when SCP chose not to apply for an extension.

Enigma Resources – Cougar Gold (PRC 8742)

In February 2007, the CSLC issued a new mineral prospecting permit to Enigma Resources LLC (Enigma) on a parcel of State land in the Bodie Hills, in a remote area of Mono County. Shortly after issuance, Enigma applied for an assignment of the permit to Cougar Gold LLC. That assignment was approved by the CSLC in June 2007 and prospecting for precious metals is ongoing.

Mineral Lease Applications

Granite Construction, Liberty Quarry Project (W 40904)

Staff continued processing an application submitted by Granite Construction Co. (Granite) for a negotiated lease on a 160-acre parcel south of Temecula in

Riverside County. An adjacent 151-acre parcel where the State also owns a 1/16th mineral interest will be included in the project. The proposed mine, designated the Liberty Quarry, is in the planning stages for the extraction of granitic rock. The quarry will have an anticipated life of 80 years, and revenue to the State is estimated to exceed the current cumulative revenue from all the other solid mineral leases. Staff is awaiting adoption by Riverside County of the environmental impact report (EIR) and the County's issuance of a Mining and Reclamation Plan before continuing with the application process.



Bureau of Reclamation (PRC 6735)

The U.S. Department of Interior, Bureau of Reclamation (BOR), has filed an application with San Bernardino County to reactivate the Manchester Quarry



located on a State parcel in a remote area of the Colorado Desert. The parcel is within the Dead Mountains, several miles west of the California-Nevada border. The BOR has been stockpiling rip-rap from numerous sources at strategic points along the Colorado River. The rock material from the reactivated quarry would be used to armor the levees of the Colorado River. The BOR has been

seeking sources of rock material in close proximity to the Colorado River in order to reduce transportation costs. The BOR intends to extract a minimum of 2.8 million tons of rock over a 25-year period. CSLC staff continues correspondence with the BOR, San Bernardino County, the State Department of Conservation Office of Mine Reclamation (OMR) and the BLM. A meeting was held in April 2007 with all agencies involved. The OMR has completed biologic studies and a Mining and Reclamation Plan for the proposed project.

Hi-Grade Materials (W 40842)

In early 2005, Hi-Grade Materials Co. (Hi-Grade) applied for a mineral lease to expand an existing sand and gravel pit in Lucerne Valley in San Bernardino County. Hi-Grade intends to extract more aggregate resources and alleviate



excessively steep slopes that currently exist at the pit. The proposed expansion will involve approximately 113 acres of school lands. San Bernardino County is finalizing its Conditional Use Permit (CUP) regarding the mining and reclamation plan for Hi-Grade's expansion. After receiving the final County CUP, Hi-Grade will complete its application for consideration of a mineral extraction lease by the CSLC.

Mineral Exchange Applications

Kaiser Resources (W 40871)

Kaiser's application to exchange the State's reserved mineral interest on a 467-acre parcel of school lands for a partial interest in a nearby mineral estate owned by Kaiser remains in abeyance. The parcel is within the Eagle Mountain Mine Complex, an open pit iron ore mine in Riverside County that last operated in 1982. The CSLC had issued a lease to Kaiser in 1978 covering 145 acres of the 467-acre parcel. The lease expired in 2002. Work on the proposed exchange has been suspended pending resolution of a ruling by a Federal District Court on an exchange between Kaiser and the BLM.



Abandoned Mine Lands

In 2002 the CSLC began to inventory and remediate abandoned mine features on State school lands. Of the 1,190 fee-owned school lands parcels managed by the CSLC, there are at least 118 parcels with nearly 750 individual mine features. CSLC staff has been performing office and field inventories of many of these parcels. In August 2006, mine warning signs designed by CSLC staff were manufactured by Prison Industries. The signs are being posted while conducting field work associated with the inventory process.



During the year, CSLC staff closed hazardous features at the Guadalupe and Golden Queen Mines in Imperial County, at the Los Padres Mine in San Bernardino County, and at the Rusty Gold and Stone Cabin Mines in Riverside County. Mine closure work included installation of polyurethane foam plugs and the backfilling of numerous mine features. Initial

inspections were also conducted on 17 school lands parcels in remote desert areas of Imperial, Inyo, Kern, and San Bernardino counties. The California Department of Fish and Game requires that all underground mine features be inspected for biological resources prior to any closure work being performed. Biologic surveys were conducted at mine features at ten separate parcels within Imperial, Kern, and San Bernardino counties.

OIL & GAS PROGRAM

Revenue from the oil & gas program totaled \$410,801.21 for FY 2006-07, an 18% decrease from the prior year. Oil production decreased by nearly 20% on the two school lands parcels where the State has a 1/16th reserved mineral interest. Average oil prices increased during the year, but only by 2%. The vast majority of the revenue, \$407,733.33, came from the 160-acre Round Mountain parcel (VA 5310) located northeast of Bakersfield in Kern County. The parcel is part of a unit operated by MacPherson Oil Company. The balance of the revenue, \$3,067.88, came from the seven-acre Sulfur Crest parcel (LA 9252) located in Ventura County. The Ventura County parcel previously had been reported as being within the Santa Paula oil field, but it actually is within the Ojai oil field.



Round Mountain field, Kern Co.

REFERENCE MAP FOR PARCELS ASSOCIATED WITH GEOTHERMAL, SOLID MINERALS, AND OIL & GAS PROGRAMS



**SUMMARY OF REVENUE GENERATED FROM GEOTHERMAL,
SOLID MINERALS, AND OIL & GAS PROGRAMS -
FISCAL YEAR 2006-07**

STRS FUND

Geothermal Royalties and Net Profits:

Royalties from leases:	\$ 4,846,383.43
Royalties from 1/16 th agreement:	\$ 11,086.99
Net Profits from lease:	\$ 693,820.84
Geothermal Total:	\$ 5,551,291.26

Solid Minerals Royalties:

Royalties from leases:	\$ 548,680.72
Royalties from 1/16 th agreement:	\$ 60,772.79
Solid Minerals Total:	\$ 609,453.51

Oil & Gas Royalties:

Oil & Gas Total:	\$ 410,801.21
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TOTAL GROSS REVENUE: \$ 6,571,545.98

FISCAL YEAR 2007-08 PLANNED ACTIVITIES

GEOHERMAL PROGRAM

The Geysers

Staff estimates revenue from school lands geothermal leases at The Geysers will again reach \$5 million in FY 2007-08. Steam production and prices are expected to remain relatively stable.

During FY 2007-08, staff expects to process a request for a deferment of the drilling obligation on one lease, and negotiate terms for the issuance of another lease to Geysers Power Co. The drilling of new production wells could occur next year on one or both of these leases. The wells would either be connected to the existing geothermal infrastructure or to new generating facilities that Geysers Power Co. might propose building if it is successful in securing new contracts for the sale of electrical power.



Geothermal Prospecting Permit

Staff plans to meet with Deep Rose to discuss its efforts to initiate exploratory drilling on the 640-acre school lands parcel in Inyo County covered by its geothermal prospecting permit. Deep Rose may likely request an extension due to the difficulties in securing the necessary funding and the problem of finding a suitable drilling contractor. Drilling rigs are currently in short supply due to high crude oil prices.

Geothermal Applications and Competitive Leasing Nominations

Staff plans to assess the desire of industry for a competitive bid lease sale for school lands north of the developed portion of The Geysers. In the absence of a nomination for competitive leasing, staff plans to process applications for prospecting permits submitted by subsidiaries of U.S. Renewables Group.

Staff also plans to proceed toward a competitive bid lease sale for school lands in the Truckhaven area of Imperial County. A reimbursement agreement will be executed with Ormat to cover staff costs.

SOLID MINERALS PROGRAM

Mineral Lease Management

Staff estimates revenue from school lands solid mineral leases will exceed \$600,000 in FY 2007-08 as it did the prior year. Staff will work with Inyo County and the State Office of Mine Reclamation on reclamation issues before recommending the CSLC accept the quitclaim submitted by U.S. Borax for its lease at the Gerstley Mine. Hanson Aggregates is expected to increase production at its Lakeside quarry to levels achieved several years ago. Western Mesquite should resume production on its BLM and private lands, but not on its State lease until 2011 or 2012. Sigma Stone is likely to continue increasing production at its Black Angel quarry. Protech Minerals is not expected to return its Pioneer Quarry to production next year due to a suppressed talc market. Granite Construction is likely to return its Ludlow pit to production as a result of anticipated contracts for the supply of road-base aggregates for the repair and widening of Interstate 40 between Barstow and Needles.

Mineral Lease Applications

Staff will continue processing applications that should result in new leases within the next few years. Those leases will have a significant positive impact on the revenue generated by the solid minerals program.

Staff anticipates resolution in early 2008 of Hi-Grade's appeal of San Bernardino County's terms for a mining and reclamation plan for its Lucerne Valley Pit. As a result, a negotiated lease should be ready for consideration by the CSLC in the 2008. Granite Construction is forging ahead with its plan to permit and produce granitic rock from the proposed Liberty Quarry in southern Riverside County. The Draft EIR for that project is anticipated in December 2007, with the Final EIR expected in 2008. Staff expects the CSLC to consider issuing a lease to Granite in FY 2008-09. The lease could more than double the current royalties from solid mineral leases on school lands. Staff plans to continue working with San Bernardino County and BOR during the environmental review of BOR's proposal to reactivate its Manchester Quarry. That review is not expected to be completed until the second half of FY 2007-08, at which time the CSLC can consider issuing a new lease to BOR for mineral extraction. Staff estimates that revenue from that lease could exceed \$3 million over the expected 25-year project life.

Mineral Exchange Applications

Staff does not anticipate completing Kaiser's proposed mineral exchange during FY 2007-08. Kaiser has placed its proposal on hold pending appeal of the Federal District Court ruling regarding its land exchange with the BLM, which is likely to require a significant length of time to resolve.

Mineral Prospecting Permit Applications

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

Abandoned Mine Lands

Staff will continue to inventory and remediate hazardous mine features located on school lands parcels. Numerous mine closures are planned during FY 2007-08 on parcels in the Calico Mountains, Fry Mountains, Johnson Valley, Mohawk Hill, Ship Mountains, Standard Hill, Superior Valley, Turquoise Mountain, and the Whipple Mountains in San Bernardino and Kern Counties. Inventory work will also continue, as will biologic and historic surveys, posting mine warning signs, and erecting fences around mine features as needed. Inventory and remediation work is expected to be completed by 2020.

OIL & GAS PROGRAM

Staff estimates revenue from the two school lands oil & gas parcels will reach \$400,000 during FY 2007-08, as strong crude oil prices continue to encourage operators to undertake projects that maintain production rates in older fields.

FINANCIAL SUMMARY: FISCAL YEAR 2006-07

STRS FUND

REVENUES AND EXPENSES

Revenues:

Surface Rentals	\$	143,745.90
Geothermal	\$	5,551,291.26
Solid Minerals	\$	609,453.51
Oil and Gas	\$	410,801.21
GROSS REVENUES	\$	6,715,291.88
Less: Geothermal Resource Development Account (GRDA) Deposits.....	\$	<65,156.19>
(Public Resources Code Section 3826)		
TOTAL	\$	6,650,135.69

EXPENSES: Net Management Costs

Land Management	\$	288,202.62
Geothermal	\$	451,064.43
Solid Minerals	\$	141,075.48
Oil and Gas	\$	3,738.17
Ownership Determination	\$	110,248.86
GROSS EXPENSES	\$	994,329.56
Less: Reimbursement Recovery	\$	<60,716.04>
TOTAL EXPENSES	\$	933,613.52

NET REVENUE TO STRS \$ **5,716,522.17**

SCHOOL LAND BANK FUND

Balance as of July 1, 2006.....	\$	54,446,521.03
SMIF Interest Earned Fiscal Year 2006-07	\$	2,827,546.11
Revenue from Land Sales	\$	0
Less: Expenses.....	\$	<171,563.14>
Net Revenue to SLBF	\$	2,655,982.97

BALANCE OF FUND AS OF JUNE 30, 2007 \$ **57,102,504.00**

ABBREVIATIONS AND ACRONYMS

ASD	Appraisal Services Directorate, U.S. Department of the Interior
BIA	U.S. Bureau of Indian Affairs
BLM	U.S. Bureau of Land Management
BOR	U.S. Bureau of Reclamation
CDPA	California Desert Protection Act
CSLC	California State Lands Commission
EIR	Environmental Impact Report
EIS	Environmental Impact Statement
FY	Fiscal Year
GPC	Geysers Power Company LLC
LLC	Limited Liability Corporation
LMD	Land Management Division
MRMD	Mineral Resources Management Division
OWSVRA	Ocotillo Wells State Vehicular Recreation Area
PRC	Public Resources Code
SLBF	School Land Bank Fund
SCP	Southern Clay Products
STRS	State Teachers' Retirement System
SVRA	State Vehicular Recreation Area
USB	U.S. Borax, Inc.