

*Annual Staff Report
on the
Management of State School Lands
Fiscal Year 2009-10*



*California State Lands Commission
John Chiang, State Controller, Chair
Abel Maldonado, Lieutenant Governor, Commissioner
Cynthia Bryant, Director of Finance, Commissioner*

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*Submitted to

Honorable Arnold Schwarzenegger, Governor

The California State Legislature
and
The State Teachers' Retirement System*

Note to the Reader

School Lands were granted to the State of California by the federal government under the Act of March 3, 1853 (10 Stat. 244), and consisted of the 16th and 36th sections of land in each township (with the exceptions of lands reserved for public use, lands taken by private land claims, and lands known to be mineral in character). A supplementary act in 1927 extended the grant of mineral lands to the State. No federal patents to the State were required under this grant. Title to the lands vested in the State upon approval of the U.S. Township Survey Plats (subject to the exceptions described above).

Indemnity School Lands (a.k.a. Lieu Lands) - In cases of preemption due to the exceptions described above (i.e., instead of a Section 16 or a Section 36), the State was given the opportunity to select replacement lands from the United States. For each transaction, the process involved several steps. First, the State filed a list with the federal government describing the lands lost to the State due to the exceptions described above. These lands were known as base lands. Then, the State filed a list with the federal government describing other federal lands selected in place of these base lands. When the list of selected replacement lands was approved by United States, a Clear List was issued to the State. The State's rights to the base lands were relinquished back to the federal government, and title to the selected lands became vested in the State. The Clear List was the document of conveyance and there are no patents issued by the federal government.

For the purposes of this Annual Report, the term *School Lands* is used to describe both lands obtained under the Act of 1853 and Indemnity School Lands (Lieu Lands).

The Annual Staff Report on the Management of State School Lands is prepared pursuant to Public Resources Code Section 6477, which requires that the State Lands Commission report annually to the state legislature and the governor on the management of School Lands.

CALIFORNIA STATE LANDS COMMISSION

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

Fiscal Year 2009-10

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INTRODUCTION

The California State Lands Commission (CSLC), through its State School Lands Management Program (Program) manages approximately 468,600 acres of school lands held in fee ownership by the State, and the reserved mineral interests on approximately 790,000 acres of school lands where the surface estate 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, Solid Minerals, and Oil and 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 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 (i.e., 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) protecting the corpus of the trust, and 3) the continued implementation of the California Desert Protection Act Exchange Program.

Net revenue transferred to STRS during Fiscal Year 2009-10 was \$4,821,170.45, which represents a decrease of 7.1% over the prior year net revenue. Management expenses for the Program in FY 2009-10 totaled \$978,119.04, which represents a 13.7% decrease from FY 2008-09 expenses. The fiscal year-end balance of the SLBF was \$1,886,983.87 (not including a \$59,000,000 loan to the General Fund). For a summary, see the table entitled "Financial Summary: Fiscal Year 2009-10" (page 31).

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 2009-10 are described in the following pages.

SURFACE MANAGEMENT PROGRAM

The LMD 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 sale of school lands parcels to public and private entities, acquisitions of lands to enhance the resource base, and the issuance of leases for various purposes such as the production of alternative energy, agriculture, grazing, and rights of way for roads, oil and gas pipelines, and electrical transmission lines. The objectives of the Surface Management Program are to manage surface uses to generate revenue, assure ongoing viability of the resource, protect the corpus of the trust, enhance local economic development, 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 the Surface Management Program, see the table entitled "Summary of Revenue Generated From Surface Management Program - Fiscal Year 2009-10" (page 6).

FISCAL YEAR 2009-10 ACTIVITIES

STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Surface Rental Income and Revenues

The majority of the 468,600± acres of school lands are isolated, landlocked parcels, with many being non-revenue generating desert lands. However, close to a quarter of the total school land acreage is leased for revenue generating purposes. Revenues deposited into the STRS fund from approximately 105 revenue-generating surface leases in FY 2009-10 totaled \$162,556.76, which represented a decrease of 11% from FY 2008-09. Because surface rent rates are usually tied directly to land values, the decrease was primarily attributable to the decline in land values caused by the recent recession. 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 - LOAN TO THE GENERAL FUND, REVENUES, AND EXPENSES

Loan to the General Fund

In response to the State's severe budget crisis, the Legislature borrowed from numerous State funds during FY 2008-09, including \$59,000,000 from the SLBF. This loan to the General Fund was part of the Budget Act of 2008, as amended by Chapter 2, Statutes of 2009 Third Extraordinary Session. The loan is

scheduled to be repaid no later than June 30, 2013. During the term of the loan, interest will accrue based on the rate utilized by the Pooled Money Investment Account (PMIA).

Accrued Interest on the School Land Bank Fund

A total of \$12,573.86 in interest was generated by the PMIA to the SLBF during FY 2009-10. Interest accruals decreased 57.9% from the previous year due to the lower interest rates that resulted from a general downturn in economic conditions, and because of a substantially lower fourth-quarter interest payment due to the \$59,000,000 loan to the General Fund.

Expenses Charged to the School Land Bank Fund

Expenses during FY 2009-10 totaled \$103,656.27, of which \$39,582 consisted of pro rata charges by the Department of Finance for general accounting services performed pursuant to Government Code Section 11270-11277. The remaining \$64,074.27 was incurred by the abandoned mine remediation program (see Abandoned Mine Lands, pages 23 and 29).

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 designated 3.6 million acres in southern California as wilderness to be administered primarily by the U.S. Bureau of Land Management (BLM), and designated an additional four million acres in southern California to be included in the national park system. The purpose of the CDPA is to preserve areas in the California desert to protect its natural, cultural, scenic, and historical values and to provide for public enjoyment. Four hundred forty-two parcels (approximately 251,000 acres) of fee-owned school lands and more than 100 parcels encumbered by the State's reservation of mineral interests were initially identified to be 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 more than 66,000 acres of school lands to the BLM and deposits totaling over \$14.7 million into the SLBF.

During FY 2009-10, work continued on a sixth CDPA land exchange. Staff completed the negotiations on a Binding Exchange Agreement with the BLM, involving 69 parcels of school lands totaling approximately 38,434 acres. All of

these properties are located within national parks, national monuments, or federal wilderness areas. The sixth CDPA land exchange is now expected to be completed in FY 2010-11, and will result in a deposit of \$7,994,925 into the SLBF.

At the close of FY 2008-09, 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 for exchange with the BLM.

SUMMARY OF REVENUE GENERATED FROM SURFACE MANAGEMENT PROGRAM - FISCAL YEAR 2009-10

STRS FUND

Surface Rentals:

Surface Rentals:	\$ 162,556.76
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TOTAL GROSS REVENUE GENERATED TO STRS FUND:	\$ 162,556.76
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SCHOOL LAND BANK FUND

GROSS REVENUE GENERATED TO SCHOOL LAND BANK FUND:	\$ 12,573.86
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EXPENSES

Program 10 – Abandoned Mine Closure Program:	\$ 64,074.27
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Department of Finance Accounting Services:	<u>\$ 39,582.00</u>
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TOTAL EXPENSES CHARGED TO SCHOOL LAND BANK FUND:	\$ 103,656.27
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NET REVENUE GENERATED TO SCHOOL LAND BANK FUND:	\$ <91,082.87>
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FISCAL YEAR 2010-11 PLANNED ACTIVITIES

POTENTIAL STATE TEACHERS' RETIREMENT SYSTEM FUND REVENUES

Surface Rentals Income

Staff estimates that surface rentals from existing and new surface use leases on school lands parcels during FY 2010-11 will remain relatively unchanged from FY 2009-10.

Timber Harvests

There is potential for income from timber salvage and sanitation operations in FY 2010-11. 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 is difficult to predict.

Alternative Energy Projects

With the passage of AB 32, the increase in public awareness about climate change and the rise in energy prices, staff expects more interest in the long-term leasing of school lands for alternative energy projects. Some of these projects will involve utilization of wind as an energy source. These projects require the installation and operation of wind turbines that, if installed, would generate electricity that would be placed into the State's electrical grid. Other alternative energy projects will utilize solar technology such as photovoltaic cells and solar-concentrating systems (troughs, towers, or dishes).

Staff plans to continue processing an application for a wind energy lease received in 2007. This proposed project, which involves 640 acres of school lands located in San Diego County, is currently in the planning stage and must undergo a review pursuant to provisions of the California Environmental Quality Act (CEQA). If the project is successfully completed and the lease is issued, staff anticipates significant revenue from this lease beginning in FY 2010-11.

Staff will continue processing two applications for solar energy leases in San Bernardino County and Kern County that together would cover more than 5,050 acres. The two proposed projects will be subject to environmental reviews under the CEQA. If these projects are successfully completed and the leases are issued, staff anticipates significant revenue from these leases beginning in FY 2010-11.

POTENTIAL SCHOOL LAND BANK FUND REVENUES AND ACTIVITIES

Applications for the following projects are currently under consideration and will be actively processed in FY 2010-11. Staff also anticipates that new requests for land exchanges and land sales will be received throughout the year.

CDPA/BLM 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 \$2,154,675. The BLM has available, through the General Services Administration, \$7,938,432.71 from surplus federal land sales designated for CDPA land purchases from the CSLC. Staff has been working with the BLM on a new proposed "Ledger Balancing Land Exchange" whereby the CSLC will transfer school lands of approximately \$10,149,600 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. As part of the transaction, the BLM also will provide a cash payment of \$56,492.29 to balance the transaction. When completed as proposed, staff anticipates \$7,994,925 will be deposited into the SLBF from this exchange. *(Editor's note: The details of this transaction were approved by the CSLC at its meeting of August 20, 2010. Staff expects this transaction to be closed late in 2010 or early in 2011.)*

State Parks Land Sale (SA 5763)

The California Department of Parks and Recreation (State Parks) submitted an application in FY 2005-06 to purchase 5,758 acres of school lands for a State Vehicle Recreation Area (SVRA). The land consists of nine full sections located in Imperial County west of the Salton Sea. State Parks already has completed an acquisition involving 4,000 acres of privately-owned land for the project, and the nine sections of school lands are arranged in a checkerboard pattern amid this previously acquired property. The proposed sale is currently on hold as State Parks contracts for environmental and cultural resource surveys for a new General Plan that will be prepared as part of State Parks' project. It is now contemplated that significant portions of the proposed acquisition will be set aside for protection of environmental and cultural resources.

LeBaron Land Sale (SA 5766)

During FY 2008-09, staff received an application from Terri R. LeBaron to purchase approximately 2,116 square feet of indemnity school lands located within the City of Yreka. The property abuts an improved residential parcel already owned by Ms. LeBaron. The purpose of the transaction is to rectify a minor surveying error that occurred during the 1950s. Upon completion of this transaction, \$9,522 will be deposited into the SLBF. *(Editor's note: This transaction closed in the first quarter of FY 2010-11.)*

New Investments – Agricultural Land and Ground Leases

Staff will continue to research potential new investments for SLBF monies in FY 2010-11, concentrating 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. However, the reduction of available funds due to the loan to the General Fund (see Page 3) significantly reduces the flexibility of potential investments.

Potential Hazards on School Lands

Some school land parcels located in remote desert locations in Southern California were used by the United States military for training purposes during World War II. The military activities used live ammunition and included artillery practice, bomber training, tank warfare, and ground combat training. With the increasing 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 that might remain from these activities. Staff will continue to work with the U.S. Army Corps of Engineers to pursue the remediation of potential hazards on these lands.

GEOTHERMAL, SOLID MINERALS, AND OIL & GAS PROGRAMS

The MRMD is responsible for the Geothermal, Solid Minerals, and Oil & Gas Programs, which involve leasing and managing school lands for the development of geothermal energy, mining activities, and oil and gas operations. These programs strive to maximize royalty revenue while protecting the environment and assuring public safety. For a summary of the revenues generated to STRS through these programs, see the table entitled “Summary of Revenue Generated from Geothermal, Solid Minerals, and Oil & Gas Programs – Fiscal Year 2009-10” (page 26).

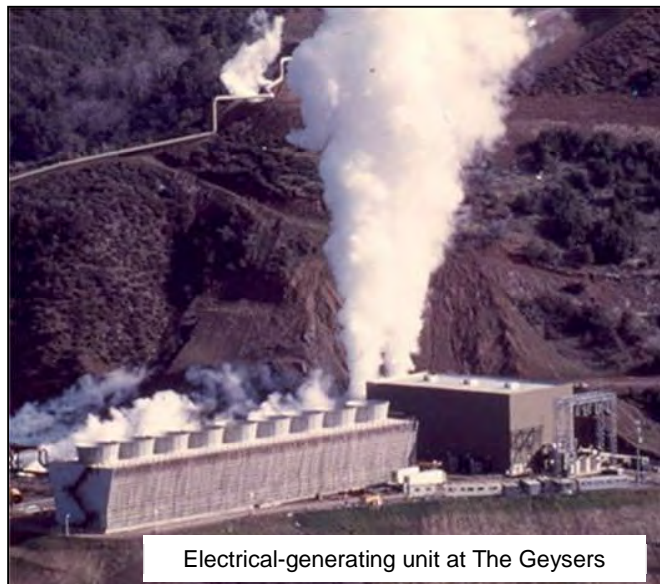
FISCAL YEAR 2009-10 ACTIVITIES

GEOTHERMAL PROGRAM

Revenue from the geothermal program totaled \$4,737,937.58 for FY 2009-10, a 13% decrease from the prior year. The revenue comes from royalties paid on the production of geothermal steam from State leases located at The Geysers geothermal field in Sonoma and Lake Counties.

Geothermal Leases at The Geysers

In 2010, The Geysers celebrated 50 years of commercial operation, and it is still the largest geothermal energy project in the world. The field currently generates 800 megawatts of electricity, enough to supply one million households. Steam production peaked in 1987 and declined sharply through 1995, but production has been stable over the past 15 years. The stability is due to consolidation of field operations and increased injection of water into the subterranean steam reservoir. The water for injection is piped to the field from wastewater reclamation plants in nearby Lake County and the City of Santa Rosa.



Electrical-generating unit at The Geysers

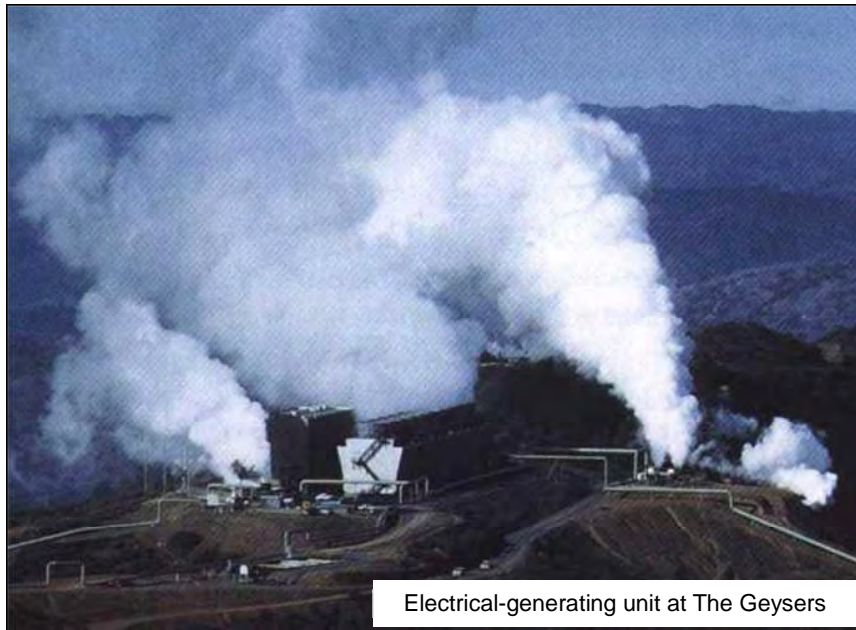
The State owns a 100% mineral interest in 7,247 acres currently under lease, plus a 1/16th interest in another 895 acres. State lands supply nearly 30 million pounds of steam per year, or 25% of the total steam produced in the field. The balance of the steam comes from Federal and privately-owned lands. The

following cumulative statistics are for active and previously productive State leases and 1/16th interest parcels from 1972 through June 2010:

PRC	Status	Acres	Leased	Rate	Cum. Steam, lbs	Cum. Royalty
4596	Producing	2,543	1971	10.0%	974.8 billion	\$105,771,804
4596 "A"	Producing	158	2008	10.0%	444.3 million	\$63,142
4597	Producing	1,445	1971	10.0%	479.1 billion	\$52,855,438
5206	Producing	130	1976	12.5%	25.0 billion	\$14,694,743
6422	Producing	250	1974	12.5%	8.5 billion	\$1,132,842
7179	Producing	361	na	6.25%	8.9 billion	\$321,101
7845	Producing	440	1995	12.5%	7.7 billion	\$1,151,722
8556	Drilling	1,881	2004	10.0%	-0-	\$0
8844	Drilling	400	2009	10.0%	-0-	\$50,000
5217	Quitclaimed	434	1977	10.0%	17.8 billion	\$3,125,430
7177-78	Quitclaimed	534	na	6.25%	21.9 billion	\$2,234,790
7751	Quitclaimed	775	1994	10.0%	491.5 million	\$57,016
6423	Quitclaimed	172	1974	12.5%	2.3 billion	\$229,101
TOTALS			1972-2010		1.5 trillion	\$181,687,128

Steam production from State leases at The Geysers in FY 2009-10 decreased by 3% from the prior year. The value of that production also decreased due to lower prices for the electricity generated from the steam.

In September 2009, the CSLC approved a new lease in the extreme northwest part of the field. Lease PRC 8844 was issued to Geysers Power Company LLC (Geysers Power), a subsidiary of Calpine Corporation. In April 2010, leases PRC



Electrical-generating unit at The Geysers

8844 and PRC 8556 were assigned to another Calpine subsidiary, CPN Wild Horse Geothermal LLC (CPN Wild Horse) to facilitate financing for exploration and development work on the two leases and adjacent private and Federal parcels.

Geysers Power remains the lessee for five of the State's seven active leases, and owner and operator of 17 of 22 electrical-generating units at The Geysers.

Geysers Power and CPN Wild Horse successfully drilled three new wells and re-drilled two previously-abandoned wells on lease PRC 8556, with another new well in progress at year end. This level of drilling activity has not occurred on State leases at The Geysers since the mid-1980s. However, the new and re-drilled wells must remain idle until a decision is made to construct a new electrical-generating facility, or use the steam resources at an existing facility.



Drill rig on new State well at The Geysers

Geothermal Prospecting Permit (PRC 8673)

In 2006, the CSLC issued a two-year permit to Deep Rose LLC to prospect for geothermal resources on a 640-acre parcel of school lands in Inyo County. In 2008, the permit was assigned to Deep Rose Geothermal 16 LLC, a partnership of Deep Rose and Raser Technologies, and the permit was extended for two years. After Raser backed out of the partnership, Deep Rose was unable to secure financing to conduct exploratory drilling. As a result, the permit expired at the end of April 2010. Current law does not provide for further extensions, but Deep Rose could apply for a new permit. Deep Rose will probably wait until the availability of adjacent Federal land is better known. The State parcel is surrounded by Federal parcels that could be offered for lease in the near future as part of the U.S. Bureau of Land Management (BLM) Haiwee Geothermal Leasing Area. If leasing occurs on the surrounding lands, staff will consider leasing the State parcel through negotiation or through a competitive lease sale.

Geothermal Prospecting Permit Applications

U.S. Renewables Group (USRG), via three wholly-owned subsidiaries, submitted applications in 2007 for permits to prospect for geothermal resources on 4,485 acres of school lands north of the developed portion of The Geysers. Staff deemed those applications to be complete in 2008. USRG secured a contractor in 2009 to begin the Initial Study required by the CEQA. The California Division of Oil, Gas, and Geothermal Resources (CDOGGR) is lead agency. The CSLC and the County of Lake are responsible agencies. The CEQA analysis must be complete before staff can present the prospecting permits to the CSLC for approval. In April 2010, USRG's contractor completed a draft Initial Study. The CDOGGR returned the draft with instructions for major revisions. The revised draft was not yet complete at the end of the fiscal year.

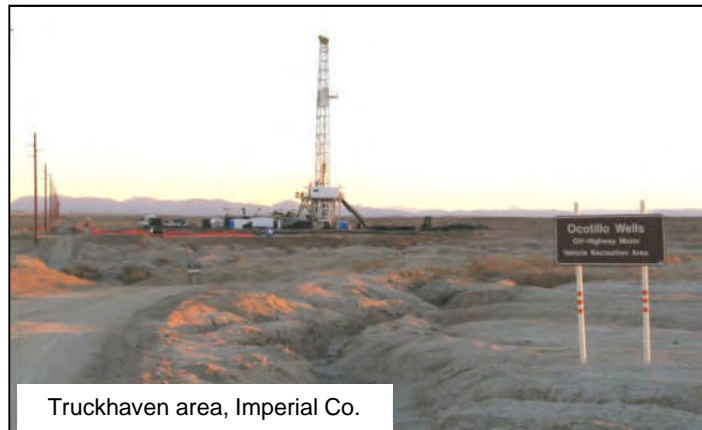
The proposed prospecting permits will include a provision that should a commercial resource be discovered, the permits can be converted into leases. If this occurs, USRG would probably propose one or more geothermal power plants in the area, which would ultimately result in new royalty revenue from the school lands parcels.

Nomination for Leasing by Competitive Public Bid

In 2007, several school lands parcels in the Truckhaven area west of the Salton Sea in Imperial County were nominated by Ormat Nevada, Inc., for leasing by competitive public bid. The parcels total approximately 4,817 acres, and are interspersed with federal and private lands. In 2008, the BLM certified an Environmental Impact Statement (EIS) for leasing 14,731 acres of federal lands

in the area. The EIS also covered the State acreage, but a supplemental analysis of environmental impacts must be completed to satisfy the requirements of the CEQA before the CSLC can offer parcels for leasing. Ormat provided funding to cover staff costs to determine the extent and cost of that supplemental analysis. Staff then

solicited bids for the analysis, and selected a contractor. But further work will require additional funding from Ormat.



In June 2010, Ormat requested staff put the nomination on hold through 2010, subject to a re-negotiation of the contractor's bid for the additional environmental analysis. Ormat and three other companies that hold leases on the 14,731 acres of federal lands issued in 2009 are struggling to meet a BLM requirement that a unit or cooperative plan of exploration and development be created. Although the BLM requirement has caused Ormat to delay funding the CEQA work, the CSLC is also committed to unitization for the State lands as well. Unitization will minimize environmental impacts to the surface lands. Much of the Truckhaven geothermal area is within the boundaries of State Parks' Ocotillo Wells SVRA. PRC Section 6924 requires that the CSLC coordinate its leasing efforts with State Parks so that geothermal exploration and development does not unreasonably interfere with use of the surface lands for recreation. CSLC staff has maintained communication with State Parks representatives and will ultimately seek approval from that agency for whatever leasing ultimately occurs on its property.

SOLID MINERALS PROGRAM

Revenue from the solid minerals program totaled \$127,655.77 for FY 2009-10, a 51% decrease from the prior year. The decrease is due to a significant reduction in aggregate mining caused by the overall downturn in the State's economy that negatively impacted housing and infrastructure construction.

The solid minerals program now manages seven leases totaling 1,260 acres, one active 1/16th reserved mineral interest parcel totaling 560 acres, and two mineral prospecting permits totaling 1,317 acres. There are also two leases totaling 465 acres, for which quitclaim deeds have been filed, but not yet formally accepted by the CSLC pending completion of reclamation. In addition to managing these mineral properties, staff continued processing applications for new permits and leases, responding to mineral inquiries, and addressing abandoned mine hazards.

Mineral Lease Management

U.S. Borax (PRC 736)

U.S. Borax, Inc. (Borax) quitclaimed its 160-acre lease in 2007, but the quitclaim has not been formally accepted by the CSLC. The lease is located at the Gerstley Mine, southeast of Death Valley in Inyo County, and was one of the first issued by the State, dating back to the 1920s.

Operations at the mine terminated in 1999. All openings were sealed for public safety in 2005, with bat-compatible gates installed at two portals, and grates anchored at two air shafts. In 2007, inspection of the underground workings was conducted and all remaining hazardous materials were removed.



Safety grating at air shaft, Gerstley Mine, Inyo Co.

In 2008, staff met with Borax, the Inyo County Planning Department, and the Department of Conservation's Office of Mine Reclamation (OMR) to review Reclamation Plan requirements prior to CSLC consideration of the quitclaim. OMR indicated that additional earthwork and re-vegetation was needed. Borax subsequently advised staff that the earthwork had been completed. However, in April 2010, staff of OMR and Inyo County conducted another inspection and determined further reclamation was needed, including additional re-vegetation and de-compaction of roads. Three buildings might have to be removed too, but

their historical value must be considered prior to that decision. Another inspection will be conducted in 2011.

Hanson Aggregates (PRC 7301)

Hanson Aggregates (Hanson) holds a 120-acre lease near Lakeside in northern San Diego County at the Vigilante Aggregate Mine. Revenue from the lease totaled \$11,634.71, substantially less than the prior year. The economic downturn has had major impacts on Hanson's aggregate sales resulting in the idling of the Vigilante quarry for about six months. The lease technically expired in 1999, but it continues in holdover status, with Hanson continuing to pay the greater of actual production royalty or the annual minimum.



In early 2009, staff inspected the lease and discussed with Hanson its future plans. Hanson indicated mine operations had been halted due to depressed sales and that a quitclaim was being considered. As a result of discussions and negotiations initiated by staff during FY 2009-10, Hanson has agreed to retain the lease pending resolution of certain lease renewal and amendment terms.

Homestake Mining Company (PRC 7808)

Homestake Mining Company (Homestake) submitted a quitclaim in 2002 for this 305-acre lease, but formal acceptance by the CSLC must await completion of site reclamation. The lease is located on the 10,000-acre McLaughlin Gold Mine in Yolo and Napa Counties. Test holes were drilled on the lease site but commercial gold ore was not discovered. The leased land was used to stockpile low grade ore that was subsequently removed and processed when Homestake ceased mining operations. In 2003, Homestake entered into a Memorandum of Agreement with University of

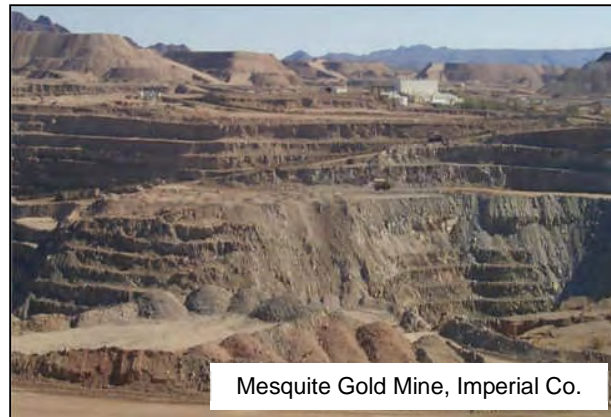


California Regents to allow use of the reclaimed property as a field research station, with an option for future acquisition. However, further discussion has yet to occur regarding the continued use of the surface following acceptance of the quitclaim. Staff last inspected the site to evaluate reclamation work in 2007.

During FY 2009-10, staff confirmed with Homestake that it is still waiting for approval from the Central Valley Regional Water Quality Control Board for a revised mine closure plan. Upon approval, Homestake will submit the plan for consideration by Lake County, which is taking the lead role for Lake, Yolo, and Napa Counties. Staff will then decide on a recommendation for formal acceptance by the CSLC.

Western Mesquite Mines (PRC 8039)

Western Mesquite Mines, Inc. (Western Mesquite) holds a 658-acre lease in the Mesquite Mine Complex, a gold mining operation in Imperial County. The mine was idled in 2001 due to low prices and the depletion of permitted reserves. When gold prices approached \$900 per ounce in 2007, mining operations were resumed.



Western Mesquite plans to develop the State lease from 2017 through 2020, near the end of the mine's expected life. This is because the lease requires a 6% royalty, the highest royalty rate among Western Mesquite's properties. With gold prices near \$1,200 per ounce, and the lease up for renewal in 2012, staff has urged Western Mesquite to accelerate its development of the State resource.

Vulcan Lands, Inc. (PRC 8253)

Vulcan Lands, Inc. (Vulcan), the largest aggregate producer in the U.S., holds a 160-acre lease at its Black Angel Quarry southwest of Barstow in San Bernardino County. Staff inspected the lease in March 2010 and observed it to be idle with a caretaker guarding the site. The lease had some production earlier in the year. Like other aggregate producers in California, Vulcan has been hard hit by



the recession and housing crisis which has significantly impacted aggregate demand. Vulcan submitted its required minimum annual royalty payment during the prior year, earlier than required, so the revenue attributable to the lease for FY 2009-10 was only \$782.66. Staff requested a meeting with Vulcan to discuss royalty, current mining operations, and future plans for the mine.

Granite Construction, Ludlow Pit (PRC 8272)

Granite Construction Co. (Granite) holds an 80-acre lease near Ludlow, in the Mojave Desert of San

Bernardino County. Granite's aggregate mine remained idle during the year. However, its location near Interstate 40 makes it an ideal source for raw material for highway construction, and Granite hopes to be the successful bidder on future road construction contracts. The annual minimum royalty of \$18,300 was received for the



Ludlow Pit, San Bernardino Co.

year. The minimum royalty increases by \$600 each year. The lease will be up for renewal in July 2011, so in October 2009, staff met with Granite to initiate discussions on amending the terms for that renewal.

Protech Minerals (PRC 8322)

Protech Minerals, Inc. (Protech) holds a 10-acre lease at the Pioneer Talc Mine in the Kingston Range in north-eastern San Bernardino County. There has been no commercial production at the mine since the lease was issued in 2001.

Protech hopes to open the mine when the domestic market for talc improves. The lease will expire in April 2011, but Protech intends to apply for a renewal. In March 2010, staff met with Protech to begin discussing renewal terms. Staff also inspected the mine site and

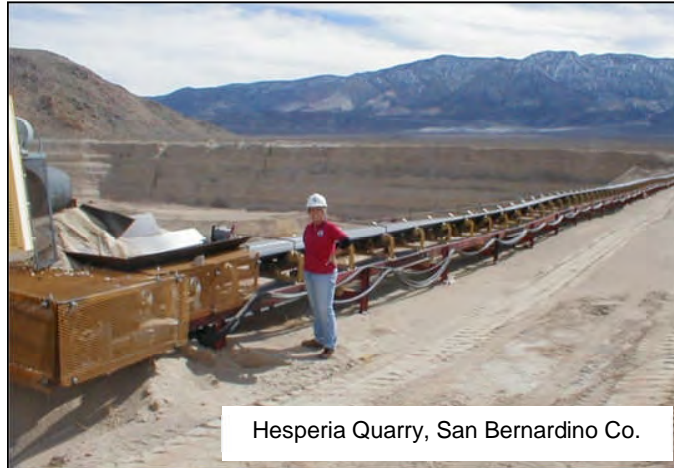


Pioneer Talc Mine, San Bernardino Co.

confirmed no significant mining had occurred since the last inspection. The annual minimum royalty of \$3,300.00 was received for the year.

Hi-Grade Materials (PRC 8831)

Hi-Grade Materials Company (Hi-Grade) was issued a negotiated lease from the CSLC effective July 1, 2009, on a 116-acre parcel to expand sand and gravel production at the Hesperia Quarry in Lucerne Valley, a remote area of the Mojave Desert in San Bernardino County. The mineral extraction lease has a primary term of seven years.



Hesperia Quarry, San Bernardino Co.

Staff inspected the lease site in March 2010, though operations did not commence at the site until a few months later. Hi-Grade is mining the southern pit wall to alleviate an overly steep pit slope that does not meet current County ordinances. The first royalty payment is expected in July 2010.

Granite Construction, Palm Desert Pit (PRC 7945)

Granite extracts sand and gravel from a large open pit mine near Palm Desert in Riverside County. Included within the pit is a 560-acre parcel in which the State owns a 1/16th reserved mineral interest. The State's royalty is fixed at \$0.04 per ton of material mined. Revenue from the parcel totaled \$13,638.40, about 37% less than the prior year due to a downturn in construction in the Coachella Valley region, which includes Palm Springs and Palm Desert.

Jacobson Construction (W 40783)

Jacobson Construction (Jacobson) mines aggregate in an area west of Baker in San Bernardino County.

Jacobson's operations include a parcel of land in which the State owns a 1/16th reserved mineral interest. Staff finally resolved the issue of unpaid royalty from prior mining activity on the parcel.

In December 2009, staff inspected the site to confirm that it had been reclaimed, and that no mining activity was occurring.



Jacobson Quarry, San Bernardino Co.

The CSLC then approved the payment of \$80,000.00, credited for the year, as settlement for prior mining. Any material removed from the parcel after the December 17, 2009, settlement date will require notification, a written agreement, and payment of royalty to the State.

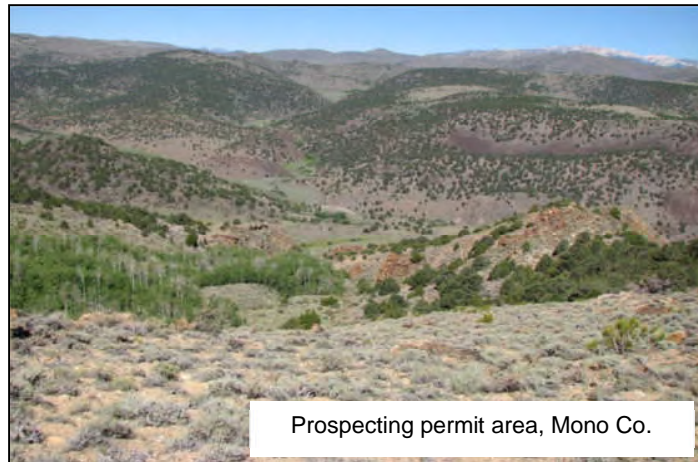
Mineral Prospecting Permits

Cougar Gold LLC (PRC 8742)

Cougar Gold LLC (Cougar) held a prospecting permit on a 480-acre parcel northeast of Bridgeport in Mono County that may be rich in precious metals. The permit, issued in 2007 for one year, then twice extended an additional year, authorized Cougar to explore for minerals by mapping geologic features and obtaining rock samples.

In December 2009, staff informed Cougar of the permit's February 28, 2010, expiration date and discussed Cougar's option of applying for a new

permit. Cougar chose not to apply and staff authorized the release of its certificate of deposit upon the condition Cougar remedies any damage to the leased lands from its activities if staff finds such damage during a planned inspection in the summer of 2010.



CPX Uranium, Inc. (PRC 8805)

CPX Uranium, Inc. (CPX) holds a prospecting permit on two adjoining State parcels totaling 837 acres in a remote desert area in the Coso Range of Inyo County where exploration by the federal government in the 1960s revealed the presence of uranium deposits. CPX plans to conduct geologic mapping, rock chip sampling, bulk sampling, and a scintillometer survey of existing drillholes to delineate the extent of the uranium mineralization and determine if additional work is warranted.

In April 2010, CPX submitted an application to extend the permit beyond its October 31, 2010, expiration date. After review of the application and exploration progress to date, staff will likely recommend the CSLC approve a one-year extension.

Mineral Lease Applications

Granite Construction, Liberty Quarry (W 40904)

Granite Construction (Granite) submitted an application in 2004 for a negotiated mineral extraction lease on a 151-acre parcel south of Temecula in Riverside County. Granite plans to open a new mine, designated the Liberty Quarry, to extract granitic rock for aggregate. The proposed lease and an adjacent 160-acre parcel where the State owns a 1/16th mineral interest will be included in the project.



In May 2010, following receipt of additional information, staff deemed Granite's application complete. The Riverside County Planning Department, as CEQA lead agency, is preparing an Environmental Impact Report (EIR) that it hopes to complete by the end of 2010, at which time it would be considered for certification by the County's Planning Commission. In June 2010, staff met with Granite to begin negotiating terms for a mineral extraction lease.

Bureau of Reclamation (PRC 6735)

In 2000, the U.S. Bureau of Reclamation (BOR) filed applications with the CSLC and San Bernardino County Planning Department to resume mining at the



Manchester Quarry that ceased operating in 1994. The State parcel is located in a remote area of the Mojave Desert near the California-Nevada-Arizona border. The BOR plans to extract 2.8 million tons of rock over a 25-year period to armor levees along the Colorado River to protect life and property.

Staff met with BOR, San Bernardino County, and the OMR in 2007 to discuss the status of the project and outstanding elements needed to proceed. In 2008, staff provided additional information requested by the County. According to OMR,

biologic studies and a Mining and Reclamation Plan have been completed for the proposed project. In October 2009, a mining geologist for the County completed an annual Surface Mining Inspection Report which cited several violations and deficiencies. In March 2010, BOR advised OMR that it has no interest in the parcel, nor is it responsible for the outstanding deficiencies at the quarry. Subsequent discussions between the County, BOR, and OMR have placed the applications back on track. The County and OMR met in June 2010 to discuss completion of a slope stability analysis and a possible expansion of the north end of the quarry to alleviate overly steep slopes. In June 2010, OMR geologists were mapping the quarry in preparation for the stability analysis. Access to the quarry across a one-mile section of the Dead Mountains Wilderness Area will require a right-of-way permit from the BLM.

Mineral Exchange Application

Kaiser Resources (W 40871)

Kaiser Resource'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 remains in

abeyance. Work on the proposed exchange was suspended pending a legal appeal to the 9th Circuit Court of Appeals. A ruling is expected soon. The parcel is in the Eagle Mountain Mine Complex, a several thousand acre area of open-pit iron mines in Riverside County. Kaiser held a 145-acre lease within the parcel between 1978 and



Eagle Mountain Mine, Riverside Co.

2002, but mining of iron ore was halted in 1982. Kaiser subsequently obtained a permit from Riverside County to open and operate a landfill at the site to serve the greater Los Angeles area. Contracts are in place for Kaiser to sell the landfill to the Los Angeles County Sanitation District, but the landfill project has been delayed due to litigation.

In June 2009, Eagle Crest Energy Company filed an application for a license from the Federal Energy Regulatory Commission for its Eagle Mountain Pumped Storage project. The project would involve pumping water from the Colorado River Aqueduct and storing it in a series of open pits at the complex. Water

would be pumped at night to reservoirs at relatively high elevations. The water would flow through turbines to a lower reservoir during the day when electrical demand is high. The system could generate up to 1,300 megawatts of electricity. A draft EIR/EIS is currently being prepared for the project.

Abandoned Mine Lands

The CSLC continued its cooperative effort with the OMR through a Memorandum of Understanding to inventory and remediate abandoned mine features located on school lands. Staff participates in quarterly OMR forum meetings with local, county, State, and federal agencies, as well as contractors, environmental groups, and the public.

In August 2009, staff received a comprehensive report by the California Natural Resources Agency summarizing an OMR inventory of chemical and physical hazards on lands managed by the State, including school lands. Through the Governor's office, the Resources Agency directed OMR to take the lead in prioritizing and coordinating remediation of these sites, and encouraged State agencies to cooperate with the OMR and with each other. OMR consulted with the Department of Toxic Substances Control on the chemical hazards and found that those present on lands managed by State Parks were of a higher priority for remediation.

Staff met with OMR shortly after the report was released to discuss its findings and specific plans for physical and chemical remediation. The report states there are 1,213 abandoned mine features located on 143 school lands parcels. Five of those parcels are reported to contain chemical hazards resulting from processing of minerals. In September 2009, staff posted signs on those five parcels warning that some form of chemical contamination from past mineral processing operations may be present.

In early 2010, staff was alerted by a concerned citizen that vandals had broken through the concrete and steel closure of the Los Padres Mine adit near Landers in San Bernardino County. In preparation for a more permanent closure, an internal survey was conducted with Dr. Pat Brown, a biologist and renowned bat expert. Although no bat or other significant wildlife usage was discovered, Dr.

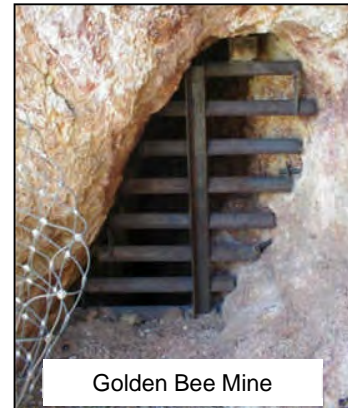


Brown recommended installing a bat gate because of the extensive underground workings and favorable climatic conditions in the mine. Dr. Brown understood

when staff proposed a hard closure, based on concerns that any bat gate would be subject to vandalism due to the remote location. In March 2010, staff consulted with the California Department of Fish and Game and the State Historic Preservation Office on plans for a hard closure of the portal by burial with existing mine waste rock. In late March, a wildlife exclusion was performed at the site over a two-night period, followed by hard closure by use of a bulldozer.

In April 2010, staff acquired a lightweight portable generator capable of being hand-carried to more remote locations inaccessible by vehicle. The generator can power tools needed to drill into solid bedrock for the installation of fence posts. Staff previously had no capability to install fences around mine shafts in more remote locations as simple post-pounders could not penetrate solid rock.

In May 2010, staff performed an inspection of two bat gates installed the prior year adjacent to the Golden Bee Mine north of the Cholla Gardens in Joshua Tree National Park. Both gates remain in good condition with no vandalism or erosion due to natural forces.



In May 2010, following annual recertification with the Mine Safety and Health Administration (MSHA), staff returned to the Ship Mountain parcel where a 60-



foot deep shaft had been backfilled and a bat gate installed on the adit in 2008. An out-flight survey for bats was performed with night vision equipment. Several dozen bats emerged from the gated mine indicating the bat population may be increasing now that the mine is protected from human visitation. Fencing was installed on the solid rock hillside. Earth-tone paints were applied to disguise the fence posts and

wire to decrease visibility and thereby prevent attraction.

Staff performed an internal inspection in May 2010 at the Mohawk Hill Mine in the Clark Mountains of San Bernardino County. The bat gate installed in 2008 remains in good condition with little sign of visitation. An out-flight survey showed that bat usage remains minimal with no detectable increase. Desert tortoise habitation at the mine continues through the use of a tortoise gate.

Also in May 2010, geologists from the National Park Service and OMR assisted staff in the installation of a fence at the Little Dove Mine about 10 miles east of Baker in San Bernardino County. The Little Dove Mine shaft is about 45 feet deep and presents a hazard to the public and wildlife. Although the mine is located in Wilderness, within the East Mojave Preserve, the mine and adjacent camp still attracts hikers as the mine is within one mile of an existing paved road.



Little Dove Mine, San Bernardino Co.

OIL & GAS PROGRAM

Revenue from the oil & gas program totaled \$871,610.87 for FY 2009-10, a 64% increase from the prior year. Oil production increased by 50% on the two school lands parcels where the State has a 1/16th reserved mineral interest. The average oil price increased by 9% over the prior year, averaging \$69.16 per barrel. Most of the revenue, \$870,395.50, came from the 160-acre Round Mountain parcel (VA 5310) located northeast of Bakersfield in Kern County. The parcel is part of a unit operated by MacPherson Oil Company. The balance of the revenue, \$1,215.37, came from the seven-acre Sulfur Crest parcel (LA 9252) located in the Ojai oil field in Ventura County.



Round Mountain Oil 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 2009-10**

STRS FUND

Geothermal Royalties:

Royalties from producing leases:	\$ 4,427,720.62
Royalties from 1/16 th agreement parcel:	\$ 11,556.97
Supplemental Royalty from one lease:	\$ 298,659.99
Geothermal Total:	\$ 4,737,937.58

Solid Minerals Royalties:

Royalties from leases:	\$ 34,017.37
Royalties from 1/16 th agreement parcels:	\$ 93,638.40
Solid Minerals Total:	\$ 127,655.77

Oil & Gas Royalties:

Oil & Gas Total:	\$ 871,610.87
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TOTAL GROSS REVENUE: \$ 5,737,204.22

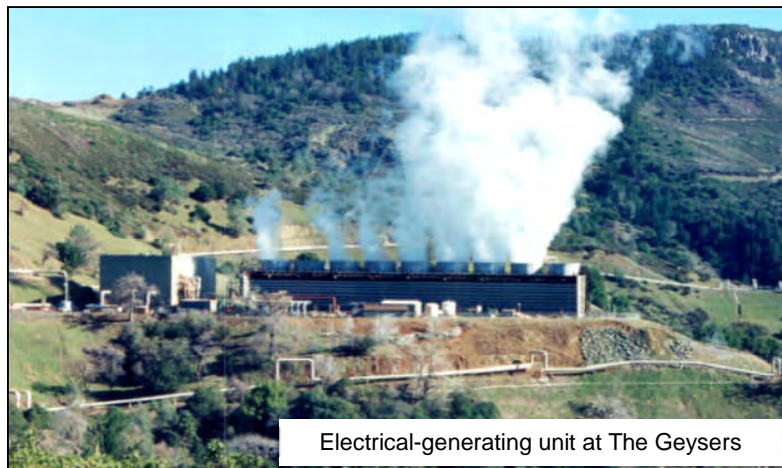
FISCAL YEAR 2010-11 PLANNED ACTIVITIES

GEOHERMAL PROGRAM

The Geysers

Staff estimates revenue from school lands geothermal leases at The Geysers will reach \$4.3 million in FY 2010-11. Steam production on developed leases is expected to decline slightly, while prices for electrical power are expected to remain stable.

Undeveloped leases where exploratory and confirmation drilling is underway might begin producing steam resources during the year, but such production will initially have a relatively minor impact on the overall level of production and revenue from the field.



Electrical-generating unit at The Geysers

Staff plans to continue reviewing new drilling proposals from CPN Wild Horse and Geysers Power, and monitoring field development activities to maximize recovery of geothermal resources and revenue from the State's school lands at The Geysers.

Geothermal Applications and Competitive Leasing Nominations

Staff plans to review the environmental documentation prepared for the CEQA lead agency, CDOGGR, for the U.S. Renewables Group applications for geothermal prospecting permits on school lands in the northern part of The Geysers, and to recommend the CSLC issue those permits.

Staff plans to keep in contact with Ormat regarding its nomination of school lands in the Truckhaven area of Imperial County for leasing by competitive bid. That nomination is presently on hold. Staff also plans to monitor federal leasing efforts in Inyo County adjacent to the school lands parcel previously covered by a geothermal prospecting permit held by Deep Rose. Interest in exploring and developing that area could be renewed in the near future. The same is true for other areas within California where the State owns one or more isolated school lands parcels near larger federal land holdings that could have geothermal potential.

SOLID MINERALS PROGRAM

Mineral Lease Management

Staff is optimistic that revenue from solid mineral leases will exceed \$100,000 in FY 2010-11 due to increased demand for aggregate and other mineral commodities following stabilization of the economy.

Staff will continue to work with Inyo County and the OMR to ensure reclamation is complete before recommending the CSLC accept the quitclaim deed submitted by U.S. Borax for the Gerstley Mine lease (PRC 736). Staff anticipates another site inspection with all involved agencies in the spring of 2011.

Staff is hopeful that the economic recovery will induce Hanson to bring the Vigilante Quarry (PRC 7301) back on production. The quarry was idled due to depressed sales and excessive fines. The minimum annual royalty is due July 25, 2010. Staff expects to reach agreement with Hanson on terms for amending and renewing the lease, and to recommend approval by the CSLC in late 2010.

Although Western Mesquite returned its Mesquite Mine Complex to production following acquisition of new heavy equipment, mining on the State lease (PRC 8039) is not planned until 2017. However, with the price of gold rising above \$1,200 per ounce, staff believes a new mine plan is warranted, one that increases reserves and hastens the onset of development on the lease.

Staff is hopeful the economy will stabilize and demand for aggregate will increase enough to allow the Vulcan Black Angel Mine (PRC 8253) to return to production. However, staff expects Protech's lease (PRC 8322) at the Pioneer Mine to remain challenged by the importation of inexpensive foreign talc. The lease is up for renewal early in 2011 and Protech has expressed an interest in a renewal for another five-year term.

Staff anticipates that Granite's lease (PRC 8272) at the Ludlow pit will return to production if a contract to repave a portion of Interstate 40 can be secured from Caltrans. The lease is up for renewal in early 2011, and staff will negotiate new terms with substantially increased royalties and a reduced minimum annual royalty. This will reduce Granite's carrying cost while the pit is idle, but increase the State's royalty when the pit is in production. Staff is also hopeful Granite's operation at the Palm Desert Pit (PRC 7945) can reach production levels achieved prior to the recession.

Staff will continue to monitor any mining activity at the Jacobson Quarry near Baker (W 40783) to ensure proper compensation for mineral material removed from the State's mineral interest lands.

Mineral Lease Applications

Staff plans to process two applications that should result in new leases and increased revenues in FY 2010-11. CSLC consideration of a negotiated lease with Granite for its Liberty Quarry must await the completion of an EIR by Riverside County and the issuance of a Conditional Use Permit and Mining and Reclamation Plan. The County is lead agency under the CEQA and the Surface Mining and Reclamation Act. The CSLC can only consider issuance of a lease as a responsible agency under the CEQA after the County has acted. Staff will also work with San Bernardino County during the environmental review of the Bureau of Reclamation's proposal to reactivate its Manchester Quarry for providing rock to protect levees of the Colorado River. Revenue from a State lease could exceed \$5 million over the proposed 25-year project life of the mine reactivation.

Mineral Exchange Application

Kaiser must await a ruling from the 9th Circuit Court of Appeals to determine whether the sale of the Kaiser Eagle Mountain Mine Complex to the Los Angeles County Sanitation District can be completed. The application for exchange of the 467-acre State mineral interest will remain in abeyance pending the outcome.

Mineral Prospecting Permit Applications

Staff plans to process a renewal of CPX Uranium's prospecting permit to explore for uranium minerals in the Coso Range south of Lone Pine in Inyo County. If approved by the CSLC, the permit will be extended for a one-year term.

Abandoned Mine Lands

Staff will continue to work with OMR to inventory and remediate hazardous mine features located on school lands parcels. Inventory work will also continue, as will biologic and historic resource surveys, the posting of mine warning signs, and the construction of fences around mine features. Now that OMR has completed an inventory of all State school lands and prioritized them according to the physical hazards present on them, staff will meet with OMR to discuss those with a higher hazard ranking to develop a list of



Hazardous feature, New Deal Mine, San Bernardino Co.

priorities likely needing remediation. This will be followed up by additional field work including biologic surveys to determine appropriate closure methods. Anticipated work this fiscal year includes installation of two culvert closures at the Golden Queen Prospect in Imperial County, possible backfill of the Arrow Mine in San Bernardino County, fencing of the shafts at the New Deal Mine in Death Valley National Park, and fencing of the County Line shaft near Joshua Tree National Park. Staff hopes to conduct further biologic studies with Dr. Pat Brown to assess the wildlife usage of the numerous shafts and adits found on a State parcel in the Shadow Mountains of San Bernardino County. Numerous fences have been erected to safeguard the public but more permanent closures may be in order pending results of the studies. Every effort will be made to safeguard the public and wildlife from abandoned mine features on school lands even though the furlough program continues and work hours are reduced.

OIL & GAS PROGRAM

Staff estimates revenue from the two school lands oil & gas parcels will reach \$900,000 during FY 2010-11, as high levels of oil production and prices are expected to continue.

FINANCIAL SUMMARY: FISCAL YEAR 2009-10

STRS FUND

REVENUES AND EXPENSES

Revenues:

Surface Rentals	\$	162,556.76
Geothermal	\$	4,737,937.58
Solid Minerals	\$	127,655.77
Oil and Gas	\$	871,610.87
GROSS REVENUES	\$	5,899,760.98

Less: Geothermal Resource Development Account (GRDA) Deposits.....	\$	<100,471.49>
(Public Resources Code Section 3826)		

TOTAL\$ **5,799,289.49**

EXPENSES: Net Management Costs

Land Management	\$	354,768.03
Geothermal	\$	553,505.38
Solid Minerals	\$	215,812.72
Oil and Gas	\$	3,843.48
Ownership Determination	\$	44,052.52
GROSS EXPENSES	\$	1,171,982.13

Less: Reimbursement Recovery	\$	<193,863.09>
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TOTAL EXPENSES\$ **978,119.04**

NET REVENUE TO STRS\$ **4,821,170.45**

SCHOOL LAND BANK FUND

Balance as of July 1, 2009	\$	1,978,066.28
SMIF Interest Earned Fiscal Year 2009-10	\$	12,573.86
Less: Expenses	\$	<103,656.27>

BALANCE OF FUND AS OF JUNE 30, 2010\$ **1,886,983.87**

(Note: Does not include \$59,000,000 loan to General Fund, due 6/30/13)

ABBREVIATIONS AND ACRONYMS

BLM	U.S. Bureau of Land Management
BOR	U.S. Bureau of Reclamation
CDPA	California Desert Protection Act
CDOGGR	California Division of Oil, Gas, and Geothermal Resources
CEQA	California Environmental Quality Act
CPX	CPX Uranium, Inc.
CSLC	California State Lands Commission
EIR	Environmental Impact Report
EIS	Environmental Impact Statement
FY	Fiscal Year
LLC	Limited Liability Corporation
LMD	Land Management Division
MRMD	Mineral Resources Management Division
OMR	California Department of Conservation, Office of Mine Reclamation
PIA	Pooled Investment Account
PRC	California Public Resources Code
SLBF	School Land Bank Fund
STRS	State Teachers' Retirement System
SVRA	State Vehicular Recreation Area
USRG	U.S. Renewables Group