Annual Staff Report  
on the  
Management of State School Lands  
Fiscal Year 2010-11

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Submitted to  
Edmund G. Brown Jr., 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) for the purpose of supporting public education in California, 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). References to annual revenues are for fiscal year 2010-11.

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.
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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. These interests are what remain of the 5.5 million acres granted by Congress in 1853. Most of the lands were sold by the State in the 19th Century. Management of the Program is split between two CSLC divisions, the Mineral Resources Management Division (MRMD) and the Land Management Division (LMD). 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. 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.

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) protection of the environment and compliance with the California Environmental Quality Act (CEQA).

Net revenue transferred to STRS during Fiscal Year (FY) 2010-11 was $5,092,923.53, which represents an increase of 5.6% over the prior year net revenue. Management expenses for the Program in FY 2010-11 totaled $1,036,553.27, which represents an increase of 6.0% over FY 2009-10 expenses. The fiscal year-end balance of the SLBF was $1,932,759.54 (not
including a $59,000,000 loan to the General Fund). For a summary, see the table entitled “Financial Summary: Fiscal Year 2010-11” (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 2010-11 are described in the following pages.
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 geothermal, mining, and oil and gas development. These programs strive to maximize royalty revenue while protecting the environment and assuring public safety. Historically, the activities of MRMD have generated over 95% of the annual revenues to STRS from the management of the SLBF. For a summary of the revenues generated to STRS through these MRMD programs, see the table entitled “Summary of Revenue Generated from Geothermal, Solid Minerals, and Oil & Gas Programs – Fiscal Year 2010-11” (page 18).

FISCAL YEAR 2010-11 ACTIVITIES

GEOTHERMAL PROGRAM

Managing geothermal development on school lands requires staff involvement in several specialized areas. Processing applications and negotiating leases requires input from legal and environmental staff. Drilling proposals require a technical review by engineering staff. Drilling and production operations need to be witnessed by field inspection staff for compliance with safety and pollution prevention regulations. Production reports, royalty calculations, and payments must be verified by staff with expertise in geothermal operations and lease terms.

At present, all revenue from the geothermal program comes from royalties paid on the production of steam from State leases located at The Geysers geothermal field in Sonoma and Lake Counties. That revenue totaled $4,525,835.39 for FY 2010-11, a 4% reduction from the prior year.

Geothermal Leases at The Geysers

The Geysers has been operated commercially for 51 years. It is still the largest geothermal energy project in the world. The field now 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 16 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.
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 28 billion pounds of steam per year, or 20% of the total steam produced in the field. The balance of the steam comes from Federal and privately-owned lands. Many of the State’s ownership interests were acquired by the CSLC from BLM through the indemnity selection process.

From 1972, when the first pound of steam was produced from a State lease, through June 2011, State leases and 1/16th interest parcels at The Geysers have produced a total of more than 1.6 trillion pounds of steam and yielded more than $186.2 million in royalty revenue.

For FY 2010-11, steam production from State leases at The Geysers fell by 3% from the prior year. The value of that production also decreased due to slightly lower prices for the electricity generated from the steam. Nevertheless, the current amount of electricity generated from the steam supplied by the State lands alone is enough to power more than 210,000 average homes in California.

State leases PRC 4596, 4596 “A”, 4597, 5206, 6422, 7845, and 1/16th parcel PRC 7179 are held by Geysers Power Company LLC, a subsidiary of Calpine Corporation. Geysers Power owns and operates 17 of the 22 electrical-generating units at The Geysers. State leases PRC 8556 and 8844 are held by a different Calpine subsidiary called CPN Wild Horse Geothermal LLC. CPN Wild Horse has recently obtained conditional use permits from Sonoma County to build two new generating plants. However, CPN Wild Horse could choose not to build those plants and instead construct pipelines to transport steam to existing power plants.

During FY 2010-11, the CSLC approved two amendments to PRC 8556 – one to allow development activity covered under new conditional use permits issued by Sonoma County, the other to extend the primary term to 2014. CPN Wildhorse
completed a pipeline to transport steam from two wells on PRC 8556 and that lease began generating royalty revenue in early 2011. CPN Wild Horse successfully drilled one new well and re-drilled two abandoned wells on PRC 8556 and PRC 8844. The wells will likely be used for injection. Three other new wells on PRC 8556 drilled during the previous year remain idle pending construction of a pipeline.

Geothermal Leasing Proposed in Imperial County

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 more than 4,800 acres, and are interspersed with federal and private lands. In 2008, the Bureau of Land Management (BLM) certified an Environmental Impact Statement (EIS) for leasing nearly 15,000 acres of federal lands in the area. The EIS also covered the State acreage, but supplemental analysis is required under the CEQA before the CSLC can hold a lease sale. In 2009, the BLM issued federal leases in the area, and Ormat provided funding to cover staff costs to determine the extent and cost of supplemental CEQA analysis for a State lease sale. Staff solicited bids and selected a contractor, but work was halted in 2010 when Ormat chose not to provide the additional funding required. In 2011, Ormat advised staff it had sold its federal and private leaseholds near Truckhaven to Iceland America Energy (IAE), which already held both federal and private leases. IAE later sold its interests to Nevada Geothermal Power (NGP).
The BLM has required NGP and two other federal lessees to submit proposals for forming a unit or cooperative plan of exploration and development. The CSLC will require this concept on the State lands as well, because unitization will minimize surface disturbance. Much of the Truckhaven geothermal area is within the boundaries of the Ocotillo Wells State Vehicular Recreation Area (SVRA) managed by the California Department of Parks and Recreation (Parks). PRC Section 6924 obligates the CSLC to coordinate its leasing efforts with Parks so that geothermal exploration and development does not unreasonably interfere with use of the surface lands for recreation.

In June 2011, NGP contacted CSLC staff to discuss the possibility of leasing State parcels through direct negotiation. This alternative to a competitive lease sale appears possible given NGP’s consolidated land position in the area. Further, the State lease could be authorized based on more expedient environmental review that the CEQA makes available for geothermal exploration projects. An amendment to the lease and a subsequent environmental review would be required should development be proposed later. NGP intends to submit a formal application for a negotiated lease in the near future.

Geothermal Prospecting Permit Applications

Applications were submitted in 2007 by U.S. Renewables Group (USRG) for permits to prospect for geothermal resources on 4,485 acres of school lands north of the developed portion of The Geysers field. Staff deemed the applications complete in 2008, but permits cannot be issued until environmental analysis is completed for the proposed exploratory drilling. The California Division of Oil, Gas, and Geothermal Resources (CDOGGR) is the lead agency under the CEQA. Environmental review for the southernmost parcel has already taken three years and will not be complete until late 2011. Once issued, the proposed 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.

In Inyo County, the CSLC issued a two-year permit in 2006 to Deep Rose LLC to prospect for geothermal resources on a 640-acre parcel of school lands five miles northwest of the Coso geothermal field. Deep Rose was unable to secure funding to begin exploratory drilling during the initial term. In 2008, the permit was extended two years and assigned to a partnership of Deep Rose and Raser Technologies. After Raser withdrew from the partnership, Deep Rose was again unable to obtain financing to drill and so the permit expired in 2010. Deep Rose reapplied for a new permit in 2011. The State parcel is surrounded by federal parcels that could be offered for lease in 2012 as part of the BLM Haiwee Geothermal Leasing Area. If the area contains geothermal resources in commercial quantities, development will likely require a project that combines State and federal lands.
SOLID MINERALS PROGRAM

Revenue from the solid minerals program totaled $102,800.23 for FY 2010-11, a 19% decrease from the prior year. The minimal royalty is due to a reduction in aggregate mining caused by the overall downturn in the State’s economy, which has negatively impacted housing and infrastructure construction. During the year, two leases expired after lessees chose not to exercise a right to renew. However, the CSLC did approve the issuance of one new prospecting permit.

The solid minerals program now includes four active leases totaling 1,054 acres, one active 1/16th reserved mineral interest parcel totaling 560 acres, and two active prospecting permits totaling 1,477 acres. There are also two leases totaling 465 acres that were quitclaimed several years ago, but those quitclaims await formal acceptance by the CSLC pending completion of reclamation. In addition to managing these mineral properties, staff continued processing applications for new permits and leases, responded to mineral inquiries, and addressed abandoned mine hazards.

Mineral Leases

U.S. Borax (PRC 736)

U.S. Borax, Inc. (Borax) quitclaimed its 160-acre lease in 2007, but the CSLC cannot accept the quitclaim until reclamation is complete. The lease is located at the Gerstley Mine, southeast of Death Valley in Inyo County.

Mine openings were sealed for public safety in 2005, with bat-compatible gates installed at two portals, and grates anchored at two air shafts. An inspection was conducted in 2007 and all remaining hazardous materials were removed. In 2008, the Office of Mine Reclamation (OMR) decided additional earthwork and re-vegetation was needed. Borax advised staff that the earthwork was completed, but an April 2010 inspection revealed that further reclamation was needed, including some re-vegetation and de-compaction of roads.

In May 2011, staff met with OMR and Inyo County for another inspection and found that recent thunderstorms had eroded some of the reclaimed roads and newly rooted vegetation. OMR notified Borax that more reclamation work must be completed. Another inspection is planned for early 2012.
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 $7,500.00, the minimum annual royalty. The mine has not produced since 2009. The lease expired in 1999, but it continues in holdover status. Hanson continues to pay the greater of actual production royalty or the annual minimum, pending renewal of the lease and amendment of the royalty terms. During FY 2010-11, staff negotiated with Hanson on those terms. Hanson will seek approval from its management prior to the execution of lease documents and formal consideration by the CSLC.

Homestake Mining Company (PRC 7808)

Homestake Mining Company (Homestake) quitclaimed its 305-acre lease in 2002, but the CSLC cannot accept the quitclaim until reclamation is complete. The lease is located at the McLaughlin Gold Mine in Yolo and Napa Counties. Test holes failed to discover commercial gold ore. Staff last inspected the site to evaluate reclamation work in 2007.

During FY 2010-11, staff received a Public Records Act Request from a consultant of Homestake to review the lease files. Homestake has advised staff that reclamation is ongoing and approval is being sought from the Central Valley Regional Water Quality Control Board for a revised 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. (WMMI) 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. Operations resumed in 2007 when gold prices approached $900 per ounce.

In May 2011, staff inspected the lease and discussed a possible renewal with WMMI. The lease will expire in November 2012. Staff also asked WMMI if any new mine plans had been developed in response to higher gold prices, which currently exceed $1,500 per ounce. WMMI advised staff that it plans to mine 1.4 million tons of ore on the State lease by the end of 2011 and 2 million tons during calendar year 2012. The royalty rate is 6% of the gross when gold exceeds $450 per ounce. If gold prices stay above $1,500 per ounce, more than $2.0 million per year in royalty could be realized from this lease.

Vulcan Lands, Inc. (PRC 8253)

Vulcan Lands, Inc. (Vulcan) holds a 160-acre lease at its Black Angel Quarry southwest of Barstow in San Bernardino County. Staff inspected the lease in April 2011 and observed it to be idle with a caretaker guarding the site. Like similar companies, Vulcan has been hard hit by the lack of demand for aggregate. Royalty revenue to the State for the year totaled $54,000.00, the annual minimum.

Staff met with Vulcan in July 2010 to discuss mining operations and future plans. Vulcan's area manager indicated that an Interim Management Plan (IMP) was submitted to San Bernardino County. An IMP is required when a mine produces less than 10% of the prior maximum annual production. The IMP was approved by both the County and the Office of Mine Reclamation. According to the IMP, Vulcan does not plan to resume mining until 2015, and at a rate of 45,000 tons per year or less. Vulcan will advise staff if conditions improve and mining operations resume.
Granite Construction, Ludlow Pit (PRC 8272 - Expired)

The 80-acre lease held by Granite Construction Co. (Granite) near Ludlow, in the Mojave Desert of San Bernardino County, expired in March 2011. The mine has been idle for more than two years. Staff attempted to negotiate a renewal, but Granite elected not to apply for one, and instead plans to sell its land. Staff advised Granite that it still owes $18,900 for the minimum annual royalty for lease year 2010-11. The lease expiration has no effect on the County’s conditional use permit for Granite’s operations. Staff will monitor the site for any mineral production and reclamation required under the use permit.

Protech Minerals (PRC 8322 - Expired)

The 10-acre lease held by Protech Minerals, Inc. (Protech) at the Pioneer Talc Mine in the Kingston Range of San Bernardino County expired in April 2011. There was no revenue for the year, as the minimum annual royalty was credited to the prior fiscal year. There has been no production from the lease during its ten-year term. Protech had anticipated increased domestic demand for talc, but it never occurred. A site visit and a wildlife survey were conducted in May 2011 to determine mine closure and wildlife protection needs. Staff will work with San Bernardino County and the OMR to ensure the mine will be properly reclaimed.

Hi-Grade Materials (PRC 8831)

Hi-Grade Materials Company (Hi-Grade) holds a 116-acre lease to extract sand and gravel at the Hesperia Quarry in Lucerne Valley in San Bernardino County. Staff last inspected the lease site in March 2010. Lease production began in July 2010 and revenue for fiscal year 2010/11 totaled $32,236.99.
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 1/16\textsuperscript{th} reserved mineral interest. The State’s royalty is fixed at $0.04 per ton of material mined. Revenue from the parcel totaled $9,063.24 for the year.

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 1/16\textsuperscript{th} reserved mineral interest. In 2009, staff resolved the issue of unpaid royalty from prior mining activity on the parcel, and the CSLC approved the settlement payment. Before additional material can be removed, Jacobson must secure a written agreement with the State and pay a specified royalty. Staff periodically visits the site to confirm no removal of State aggregate occurs without such an agreement. None occurred during the fiscal year.

Mineral Prospecting Permits

CPX Uranium, Inc. (PRC 8805)

CPX Uranium, Inc. (CPX) holds a prospecting permit on two adjoining State parcels totaling 837 acres in the Coso Range of Inyo County. Exploration by the federal government in the 1960s revealed the presence of uranium deposits in the area. CPX plans to conduct mapping, sampling, and surveying to delineate the extent of the uranium mineralization and determine if additional work is warranted. CPX did not complete its prospecting during the original term of the permit, from November 2008 through October 2010. A one-year extension to October 2011 was approved by the CSLC, but if CPX wants to continue prospecting beyond that, it must submit an application for a new permit.

Bagdad Chase, Inc. (PRC 8917)

Bagdad Chase, Inc. (Bagdad) holds a prospecting permit covering a 640-acre parcel of fee-owned school land south of Ludlow in San Bernardino County. The one-year permit was issued by the CSLC effective May 1, 2011. Bagdad plans to conduct geologic mapping and rock chip sampling in hopes of verifying a commercial aggregate deposit.
Mineral Applications

Granite Construction, Liberty Quarry (W 40904)

Granite Construction (Granite) applied for a mineral extraction lease on a 151-acre parcel south of Temecula in Riverside County in 2004. 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. Granite’s application was finally deemed complete in May 2010. The Riverside County Planning Department, as CEQA lead agency, completed an Environmental Impact Report (EIR) in April 2011. Public hearings were conducted to discuss local concerns. Staff is waiting on Riverside County to approve or deny the project before negotiating lease terms with Granite.

Bureau of Reclamation (PRC 6735)

The U.S. Bureau of Reclamation (BOR) held a 90-acre lease between 1984 and 1994 at The Manchester Quarry in the Mojave Desert near the California-Nevada-Arizona border. Operations ceased at the quarry in 1994. In 2001, the BOR submitted an application to renew the lease. It also submitted to San Bernardino County an application to resume mining. The BOR proposed extracting 2.8 million tons of rock over a 25-year period to armor levees along the Colorado River to protect life and property.

After several years of inaction, the BOR met with staff, San Bernardino County, and the OMR in 2007 to discuss the project. The OMR indicated in 2008 that biologic studies and a Mining and Reclamation Plan were completed for the project. In 2009, a County mining geologist inspected the quarry and found numerous violations and deficiencies. The BOR advised OMR in 2010 that it had no interest in the parcel, nor was it
Enigma Resources LLC (W 40949)

Enigma Resources LLC (Enigma) submitted an application for a mineral prospecting permit in July 2010 for a 480-acre parcel northeast of Bridgeport in Mono County. A permit covering this parcel was previously issued to Enigma in March 2007, and then assigned to Cougar Gold LLC in April 2007. That permit, PRC 8742, expired in February 2010. Enigma plans to pursue the prospecting that Cougar Gold intended to carry out to demonstrate commercial viability. Enigma's application is currently incomplete because it has not submitted a detailed prospecting plan. Enigma will likely apply to Mono County for a drilling permit. That drilling would likely be classified as a non-exempt CEQA project. Enigma may need an agreement with the Flying-M Ranch/Barron Hilton to access the site, though it is also considering use of a helicopter to access the site and bring in coring/drilling equipment to minimize surface disturbance and permitting.

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. The parcel is located in the Eagle Mountain Mine Complex, a 3,000-acre area of open-pit iron mines in Riverside County. Kaiser held a 145-acre lease within the parcel from 1978 to 2002, but mining of iron ore ceased in 1982. Kaiser subsequently obtained a permit from Riverside County to operate a Class 3 landfill at the site to serve the greater Los Angeles area. Contracts were in place for Kaiser to sell the landfill to the Los Angeles County Sanitation District, but sale was delayed due to litigation. In 2009, the US Ninth Circuit Court of Appeals rendered an unfavorable ruling regarding the landfill. This decision was appealed to the full US Ninth Circuit Court of Appeals in 2010,
which also rendered an unfavorable verdict. A further appeal to the U.S. Supreme Court in May 2011 remanded the issue back to the BLM to resolve certain issues prior to commencement of the landfill.

In 2010, the CSLC was asked to comment on the environmental review for the Eagle Mountain Pumped Storage project, a proposal to pump water from the Colorado River Aqueduct at night and store it in open pits at relatively high elevations at the complex. 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. Staff also provided information regarding the State’s mineral interest at the complex, and asked the State Water Resources Control Board to advise staff as this project moved forward so that the CSLC may participate appropriately.

With rapid escalation of iron ore prices and the reopening of several small iron ore mines in southern California, the Kaiser Eagle Mountain Mine Complex is also being reviewed to determine whether resumption of iron ore mining may be economic.

**Molycorp Minerals  (Rare Earth Mine - unleased parcel)**

Molycorp Minerals LLC operates the Rare Earth Mine, an open-pit mine north of Mountain Pass in the Clark Mountain Range of San Bernardino County. The mine once supplied most of the world’s rare earth elements – the fifteen lanthanides in the periodic table, plus scandium and yttrium. The mine is currently undergoing expansion and modernization. There are 400 acres of reserved mineral interest school lands south and west of the mine. An EIR prepared for the mine’s proposed expansion to the west revealed that Molycorp intended to remove approximately 545,000 tons of material from the State parcel. Staff conducted a site inspection in March 2010, and notified Molycorp that a lease agreement would be required. A lengthy written correspondence followed, with the conclusion being that Molycorp, as the surface owner, can remove rock material without any permit, lease, or other authorization from the CSLC, provided that removal is limited to overburden material and there is no sale of aggregate or rare earth minerals. Molycorp provided geologic evidence to staff suggesting the site does not contain commercial quantities of rare earth minerals, and staff learned from San Bernardino staff that Molycorp has no plan to market the overburden for aggregate. Staff intends to formalize an understanding with Molycorp through a letter seeking its agreement to stockpile the State’s mineral resource, and apply for a lease from the CSLC should the sale of aggregate or rare earth minerals be contemplated in the future.
Abandoned Mine Lands

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

A 2009 report by the Natural Resources Agency summarized an inventory of chemical and physical hazards on lands managed by the State, including school lands. The Resources Agency directed the OMR to prioritize and coordinate remediation of the sites. The OMR and the Department of Toxic Substances Control determined that chemical hazards on lands managed by State Parks were of highest priority for remediation. Staff met with OMR shortly after the report was released to discuss its findings and specific plans for remediation. The report states there are 1,213 abandoned mine features located on 143 school lands parcels, five of which contain chemical hazards. Staff posted signs on those five parcels in 2009 warning that some form of chemical contamination from past mineral processing may be present.

During FY 2010-11, little progress was made due to a staff shortage and travel restrictions. There was no work conducted with OMR staff, as its time was completely devoted to abandoned mine lands inventory and remediation management. The OMR received multi-million-dollar contracts from the BLM and National Park Service to inventory and provide project management for remediation projects.

The only physical remediation was installation of fencing and a warning sign at the Los Padres Gold Mine in San Bernardino County. The mine is within the BLM’s Johnson Valley Off-Highway Vehicle area. A motorcycle trail is contiguous to the mine shaft. Due to rough terrain, the shaft could not be reached with heavy equipment for a backfill. This parcel is within the area proposed for expansion of the Marine Air Ground Task Force Training Command, Twentynine Palms.

A bat survey was performed at the Pioneer Talc Mine in advance of reclamation work required by San Bernardino County. Though the survey revealed minimal bat usage, a wildlife exclusion will be performed should reclamation work close the mine workings.
Revenue from the oil & gas program totaled $1,413,716.13 for FY 2010-11, a 62% increase from the prior year. Oil production increased by 29% on the two school lands parcels where the State has a 1/16th reserved mineral interest. The average oil price was 26% higher than the prior year, averaging $87.08 per barrel. Most of the revenue, $1,412,273.93, 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, $1,442.20, came from the seven-acre Sulfur Crest parcel (LA 9252) located in the Ojai oil field in Ventura County.

The designations VA and LA stand for the Visalia and Los Angeles land districts of the old California Surveyor General, a constitutional office until 1929. The sale of school lands was one function of that office, and those transactions were typically identified with the district abbreviation and a number. After 1929, the functions of the Surveyor General where transferred to the Division of State Lands within the Department of Finance, then in 1938 to a new independent agency, the CSLC.
LOCATION OF PARCELS ASSOCIATED WITH GEOTHERMAL, SOLID MINERALS, AND OIL & GAS PROGRAMS
<table>
<thead>
<tr>
<th>Source</th>
<th>Royalties from leases:</th>
<th>Royalties from 1/16th interest parcel:</th>
<th>Supplemental Royalty from one lease:</th>
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<td>$1,413,716.13</td>
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<td><strong>TOTAL GROSS REVENUE</strong></td>
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<td><strong>$6,042,351.75</strong></td>
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</table>
FISCAL YEAR 2011-12 PLANNED ACTIVITIES

GEOTHERMAL PROGRAM

The Geysers

Staff estimates revenue from school lands geothermal leases at The Geysers will reach $4.0 million in FY 2011-12. Steam production on developed leases is expected to decline slightly, while prices for electrical power are expected to remain stable. Leases PRC 8556 and PRC 8844 should continue to be developed and produce more steam during the year. The same is expected for a parcel where the State owns a 1/16th mineral interest, but the new production will have a relatively minor impact on the overall level of production and revenue from the field.

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

Staff plans to process an application from Deep Rose for a new prospecting permit in Inyo County, and 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. Staff anticipates the issuance of at least two geothermal prospecting permits in FY 2011-12.

Staff expects to receive an application from Nevada Geothermal Power for a negotiated lease on State school lands in the Truckhaven area of Imperial County. If a lease is issued, it will most likely join with leases on Federal and private lands in a geothermal unit for exploration and possible future development. Staff will be coordinating this leasing effort with staff of Parks so that geothermal activities do not interfere with recreation within the Ocotillo Wells SVRA.
Mineral Lease Management

Staff is pleased to announce that revenue from solid mineral leases will likely exceed $1.0 million in FY 2011-12 due to the commencement of precious metals mining by WMMI at the Mesquite Mine in the fall of 2011. The WMMI lease, PRC 8039, will be up for a 10-year renewal in November 2012. Staff estimates that royalty revenue from the lease for FY 2012-13 could exceed $2.0 million at a gold price of approximately $1,500 per ounce. Mining should continue for about three years, or longer if high gold prices induce a new, enlarged mine plan. A new plan would require amendment of Imperial County’s conditional use permit. WMMI is hesitant to entertain this possibility as a new plan would be subject to the backfill provision of the Surface Mining and Reclamation Act. Because this property was acquired in an exchange from the BLM as part of the California Desert Protection Act of 1994, the Federal government will receive an equal value of State inholdings within park and wilderness areas for all royalties received from this property.

Another school lands parcel that could yield substantial solid minerals revenue in FY 2011-12 and beyond, up to 70 years, is the proposed lease W 40904 at Granite’s planned Liberty Quarry. A final decision by Riverside County should be made in early 2012 on certification of the EIR and approval of the mining permit. The Planning Commission denied the permit. If ultimately approved by the county the CSLC could consider issuance of the lease in early 2012.

The downturn in the economy has definitely taken a significant toll on aggregate mines in southern California. Only two out of five school lands aggregate leases are currently producing. Of the remaining three, one expired, while the other two are idle and await an increase in demand for aggregate for road construction and maintenance and housing. Staff expects one of the idle aggregate leases, PRC 7301, to be amended and renewed in early 2012 so that Hanson Aggregates can resume production when the economy improves.

Mineral Applications

Staff plans to process two lease applications that should result in new leases and increased revenues in FY 2011-12. One is the Granite application, W 40904, discussed above. The other is the Bureau of Reclamation application, PRC 6735, for a lease at its Manchester Quarry, which is planned to be reactivated. Staff will work with San Bernardino County during the environmental review of that proposal, which potentially could result in revenue of more than $5.0 million to the State over a 25-year project life.

Staff will continue to process Enigma’s application for a mineral prospecting permit, and encourage CPX Uranium to apply for a one-year extension of its prospecting permit. The CPX permit expires in October 2011. Similarly, the
Bagdad Chase prospecting permit is scheduled to expire in April 2012, so staff will monitor the exploration work Bagdad is conducting and discuss the need for an extension.

With regard to Kaiser’s application for a mineral exchange, it will have to remain in abeyance pending the outcome of legal obstacles to a proposed landfill, environmental review of a proposed pumped storage project, and the possibility of renewed mining of iron ore.

**Abandoned Mine Lands**

Staff will continue discussions with the OMR on the inventory and remediation of hazardous mine features on school lands parcels. However, the OMR is currently obligated to focus on BLM and National Park Service contracts to conduct abandoned mine land inventory and remediation project management.

Staff plans to complete an inventory and install signage for hazardous mine features identified by the OMR as having the greatest physical risk to the public. Surveys will be required by the Department of Fish and Game and the Office of Historic Preservation prior to permitting any closures. Staff will seek approval to hire a retired annuitant to assist in this work.

**OIL & GAS PROGRAM**

Staff estimates revenue from the two school lands oil & gas parcels will reach at least $1.5 million during FY 2011-12, as high levels of oil production and prices are expected to continue.
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 2010-11” (page 25).

FISCAL YEAR 2010-11 ACTIVITIES

STATE TEACHERS’ RETIREMENT SYSTEM FUND REVENUES

Surface Rental Income and Revenues

General surface leasing involves ongoing activities, including processing new applications, re-issuing expiring leases, processing lease assignments and amendments, conducting rent reviews, terminating old leases, and conducting other surface management activities. 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 just over 100 revenue-generating surface leases in FY 2010-11 totaled $182,581.86, which represented an increase of 12% from FY 2009-10. Surface rent rates are usually tied directly to land values, which have been in decline due to the recent recession. However, revenues from LMD surface leases actually increased in FY 2010-11 because several new right-of-way leases were completed. Also, some older leases from the 1960s expired and were renegotiated at current market rent rates.
**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, Statues 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).

**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 was to rectify a minor surveying error that occurred during the 1950s. This transaction was completed during FY 2009-10 and resulted in a deposit of $9,522 into the SLBF.

**Bureau of Land Management CDPA Land Exchange (AD 556)**

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 2010-11, 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 2011-12, and will result in a total deposit of $7,994,925 into the SLBF. As part of this transaction, a partial payment of $56,492.29 was deposited into the SLBF during FY 2009-10. For more information on this exchange, see page 29.

Accrued Interest on the School Land Bank Fund

A total of $9,309.55 in interest was generated by the PMIA to the SLBF during FY 2010-11. Interest accruals decreased 26% from the previous year due to the lower interest rates that resulted from a general downturn in economic conditions.

Expenses Charged to the School Land Bank Fund

Expenses during FY 2010-11 totaled $29,548.17, all of which were incurred by the abandoned mine remediation program (see Abandoned Mine Lands, pages 15 and 21). Expenses decreased by 71.5% from FY 2009-10, primarily due to fewer mine closure activities. Also, unlike FY 2009-10, there were no pro rata charges by the Department of Finance for general accounting services performed pursuant to Government Code Section 11270-11277.
SUMMARY OF REVENUE GENERATED FROM SURFACE MANAGEMENT PROGRAM - FISCAL YEAR 2010-11

STRS FUND

Surface Rentals:

Surface Rentals: $ 182,581.86

TOTAL GROSS REVENUE GENERATED TO STRS FUND: $ 182,581.86

SCHOOL LAND BANK FUND

GROSS REVENUE GENERATED TO SCHOOL LAND BANK FUND: $ 75,323.84

EXPENSES

Program 10 – Abandoned Mine Closure Program: $ -29,548.17

NET REVENUE GENERATED TO SCHOOL LAND BANK FUND: $ 45,775.67
FISCAL YEAR 2011-12 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 2011-12 will remain relatively unchanged from FY 2010-11.

Timber Harvests

There is potential for income from timber salvage and sanitation operations in FY 2011-12. 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 Assembly Bill (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).

WIND

Staff plans to continue processing two applications for wind energy leases. The first, known as Tule Wind, was received in 2007. This proposed project involves 640 acres of school lands located in eastern San Diego County. The Tule Wind project was analyzed by the lead agency, California Public Utilities Commission, in an Environmental Impact Report (EIR) prepared pursuant to provisions of the California Environmental Quality Act (CEQA). If the project is approved and the lease is issued to allow construction and operation of the project, staff anticipates significant revenue from this lease beginning in FY 2014-15. The other wind energy application is known as Alta Windpower Development. This application was first received in 2007, but subsequently withdrawn. The applicant re-submitted the application in August, 2010. The proposed project involves 160 acres of school lands in Kern County. Because the school lands parcel is part of a future phase of this project and CEQA analysis has not even begun, staff does not expect to see revenue from this lease until FY 2014-15 at the earliest.
**SOLAR**

Staff will continue processing two applications for solar energy leases in San Bernardino County that together would cover almost 11,400 acres of school lands. The two proposed projects, Johnson Valley SEGS and Cannon Solar Partners, 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 2013-14 or FY 2014-15.

Staff also is processing an application from enXco Development for a 160-acre parcel of school lands in Kern County. This proposed project will utilize a mixture of wind and solar energy technology, but is still in the planning stages.

**Cell Tower Sites**

Staff has received information that cellular communications companies are planning on expanding their services in the rural and desert areas of the state. Staff intends to investigate the suitability of school lands parcels for cell tower sites to facilitate these expanded coverage areas.

**Desert Renewable Energy Conservation Plan/Renewable Energy Action Team**

On November 17, 2008, Governor Schwarzenegger signed Executive Order S-14-08 (Order), which established a Renewable Portfolio Standard (RPS) for California, whereby retail sellers of electricity must serve 33% of their load with renewable energy by 2020. The Order directed state agencies to take all appropriate actions to implement this target in all regulatory proceedings, including siting, permitting, and procurement for renewable energy power plants and transmission.

Also on November 17, 2008, the California Energy Commission and the California Department of Fish and Game (CDFG) signed a Memorandum of Understanding (MOU) formalizing the Renewable Energy Action Team (REAT) to facilitate the planning and realization of this RPS. The Order, among other things, directed the REAT to create a "one-stop" process for permitting renewable energy generation power plants and to work with the BLM and U.S. Fish and Wildlife Service to create a Desert Renewable Energy Conservation Plan (DRECP or the Plan) that, generally speaking, encompasses portions of the Mojave and Colorado deserts in California. The primary goals of the DRECP are to: provide for the long-term conservation and management of sensitive species and the natural communities and ecosystems on which they depend; identify the most appropriate locations in the Plan area for alternative energy development; and provide a coordinated and standardized mitigation requirement strategy that creates a more efficient process by which project applicants may obtain the necessary regulatory authorizations.
On September 1, 2011, the CSLC entered into an MOU with the REAT to facilitate coordination between CSLC staff and the REAT Agencies to ensure that REAT and DRECP goals for renewable energy development and environmental protection are accomplished in a manner that is consistent with and advances CSLC’s management objectives for School Lands in the DRECP Planning Area. The execution of this MOU, along with the passage of AB 982, discussed below, will enhance the CSLC’s role in the development of the DRECP and help facilitate the exchange of lands between the CSLC and the BLM, resulting in the consolidation of land ownership patterns to the benefit of both agencies. During FY 2011-12, staff will continue to actively participate in the DRECP for the purpose of improving the potential development of school lands for renewable energy projects involving both revenue-generation purposes and habitat mitigation and thereby maximize the value of the lands within the SLBF.

**Land Exchanges to Facilitate Alternative Energy Projects – AB 982**

During the 2011 legislative session, the Legislature passed and Governor Brown signed AB 982 (enacting chapter 2 of Division 7.7 of the Public Resources Code), which requires CSLC staff, with the cooperation of the Department of the Interior, to enter into a memorandum of agreement to facilitate land exchanges that consolidate school land parcels into contiguous holdings. AB 982 also provides that in preparing any land exchange proposal, priority must be given to exchanges that are best suited for renewable energy development projects and that are consistent with the DRECP. This law goes into effect on January 1, 2012. As an additional outcome of these efforts, environmentally sensitive lands and lands with extraordinary cultural or biological resources also will be identified, with the intent of consolidating these lands and providing for their long-term protection.

The CSLC and BLM staffs have already met to begin this process, and anticipate significant progress on this project during FY 2011-12.

**POTENTIAL SCHOOL LAND BANK FUND REVENUES AND ACTIVITIES**

Applications for the following projects are currently under consideration and will be actively processed in FY 2011-12. Staff also anticipates that new requests for land exchanges and land sales will be received during the year.

**CDPA/BLM Land Exchange (AD 556)**

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 BLM and National Park Service (NPS) 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 NPS already has provided a cash payment of $56,492.29 to balance the transaction (see page 24). However, this transaction has been stalled due to a federal audit by the General Accountability Office (GAO). Staff hopes to complete this transaction during FY 2011-12. However, the legal dispute between the GAO solicitor and the Department of the Interior solicitors is beyond the CSLC’s control. It remains uncertain as to if and when this dispute will be resolved. When completed as proposed, staff anticipates a total of $7,994,925 will be deposited into the SLBF from this exchange.

**State Parks Land Sale (SA 5763)**

The California Department of Parks and Recreation (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. 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 staff and Parks wait for the delivery and approval of a new appraisal on the subject property.

**New Investments – Agricultural Land and Ground Leases**

Staff will continue to research potential new investments for SLBF monies in FY 2011-12, 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 23) significantly reduces the flexibility of potential investments.
FINANCIAL SUMMARY: FISCAL YEAR 2010-11

STRS FUND

REVENUES AND EXPENSES

Revenues:
Surface Rentals ................................................................. $ 182,581.86
Geothermal ................................................................. $ 4,525,835.39
Solid Minerals ............................................................ $ 102,800.23
Oil and Gas ................................................................. $ 1,413,716.13
GROSS REVENUES .............................................. $ 6,224,933.61

Less: Geothermal Resource Development
Account (GRDA) Deposits ........................................... $ <95,456.81>
(Public Resources Code Section 3826)

TOTAL ................................................................. $ 6,129,476.80

EXPENSES: Net Management Costs
Land Management .............................................................. $ 347,103.50
Geothermal ................................................................. $ 452,629.31
Solid Minerals ............................................................ $ 329,536.38
Oil and Gas ................................................................. $ 3,933.53
Ownership Determination .............................................. $ 24,745.81
GROSS EXPENSES ............................................... $ 1,157,948.53

Less: Reimbursement Recovery ..................................... $ <121,395.26>

TOTAL EXPENSES ............................................... $ 1,036,553.27

NET REVENUE TO STRS ....................................... $ 5,092,923.53

_______________________________________________________________

SCHOOL LAND BANK FUND

Balance as of July 1, 2010 ..................................................... $ 1,886,983.87
Revenue from Land Sales .............................................. $ 66,014.29
SMIF Interest Earned Fiscal Year 2010-11 ........................... $ 9,309.55
Less: Expenses ............................................................. $ <29,548.17>

BALANCE OF FUND AS OF JUNE 30, 2011 ........ $ 1,932,759.54
(Note: Does not include $59,000,000 loan to General Fund, due 6/30/13)
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<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>AB</td>
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<td>Acquisition Disposition</td>
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<td>BOR</td>
<td>U.S. Bureau of Reclamation</td>
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<td>California Department of Fish and Game</td>
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<td>Desert Renewable Energy Conservation Plan</td>
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<td>Environmental Impact Report</td>
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<td>U.S. National Park Service</td>
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<td>Parks</td>
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<td>California Public Resources Code</td>
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<td>Renewable Energy Action Team</td>
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<td>Renewable Portfolio Standard</td>
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<td>Acronym</td>
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<td>SLBF</td>
<td>School Land Bank Fund</td>
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<td>State Teachers' Retirement System</td>
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<td>WMMI</td>
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