

MINUTE ITEM

This Calendar Item No. 07
was submitted for information
only, no action thereon
being necessary.

INFORMATIONAL

CALENDAR ITEM

A)
) Statewide
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10/18/91
W 23691
McDonald

ANNUAL REPORT ON MANAGEMENT OF STATE SCHOOL LANDS

PARTY:

State Lands Commission
1807 - 13th Street
Sacramento, California 95814

P.R.C. Section 6477 provides for the submittal of an Annual Report on the Management of School Lands by the Commission to the State Teachers' Retirement Board, the Legislature, and the Governor.

The report addresses the school lands asset, composed of approximately 570,000 acres of school land, and 760,000 acres of reserved mineral interest. Current revenues from such lands are dedicated to the State Teachers' Retirement Fund (STRF). Proceeds from land sales are deposited in the School Land Bank Fund (SLBF) for eventual re-investment. In fiscal year 1990-91, surface and mineral leases produced a net revenue of \$3,375,323 to the STRF. Land sales produced a net income of \$2,523,545 for the SLBF. The accrued interest on this fund for the year was \$500,158.

The report was submitted to the State Teachers' Retirement Board, to the Legislature, and the Governor on October 9, 1991.

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

AB 884:
N/A

EXHIBIT

A. Annual Staff Report on the Management of State School Lands

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EXHIBIT "A"

CALIFORNIA STATE LANDS COMMISSION

ANNUAL STAFF REPORT

ON

MANAGEMENT OF SCHOOL LANDS

Fiscal Year 1990-91

COMMISSIONERS

Leo T. McCarthy, Lieutenant Governor, Chairman
Gray Davis, State Controller
Thomas W. Hayes, Director of Finance

EXECUTIVE OFFICER

Charles Warren

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

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INTRODUCTION

The State Lands Commission (SLC) manages approximately 570,000 acres of school lands and 760,000 acres of lands with reserved mineral interest. Approximately 52,000 acres of lieu lands are still owed California by the Federal Government. During fiscal year 1990-91 management of the school lands was divided among three sub-programs. The School Lands Team is part of the Land Management and Conservation Division and manages all surface resources. The Geothermal Program within the Mineral Resources Management Division, oversees all geothermal activities. The Mineral Program, also within the Mineral Resources Management Division, oversees school land oil and gas leasing and mining activities. School lands staff continues to be augmented by other Commission staff from the legal, boundary determination, legislative, and accounting units.

The School Lands program continues to be committed to revenue enhancement of the school lands asset. Management costs, for the program as a whole, were reduced by approximately \$629,000 from the previous fiscal year. Historically the costs to operate the school lands program have been approximately 2 million dollars, but this year the costs were reduced to approximately 1.4 million dollars. During fiscal year 1991-92 there should be further reductions in management costs.

SCHOOL LANDS TEAM 1990-91 SIGNIFICANT ACCOMPLISHMENTS

The School Lands Team within the Division of Land Management oversees management of all surface activities on state school lands. This includes surface leasing, sales, and the management of 25,000 acres of timberland. This fiscal year timber sales netted \$329,378 and surface rentals netted \$305,047, totaling \$634,425 of revenue generated for the State Teachers Retirement System. Land sales generated revenue of \$2,578,209. This revenue figure includes the sale of one parcel at Mountain Home for \$140,000, and \$2,438,209 from the sale of the Norco parcel which closed escrow on June 30, 1990, but was not deposited into the School Land Bank Fund until the following fiscal year (this was shown as an unposted transaction in the 1989-90 annual report.) Accrued interest on the School Land Bank Fund was \$504,158.

SALES

In order to improve the economic return on the school lands asset, the Commission has an active sales program. Although the current recession has dampened the demand for much of the school lands, staff has focused on developing a long range sales program. In addition, when situations arise where there are opportunities to conduct sales, staff actively pursues those opportunities in order to maximize the return to the School Land Bank Fund. There was one sale this year and one sale from the previous year the receipts from which were deposited in the School Land Bank Fund this year both are described below.

Mountain Home:

This 40 acre parcel within the California Department of Forestry and Fire Protection's (CDF) Mountain Home State Forest, was sold to CDF for \$350,000. The land value of \$140,000 was deposited in the School Land Bank Fund and the value of the standing timber, \$210,000, went to the State Teachers Retirement System.

Norco:

This 67 acre parcel in Riverside County was sold to the Riverside Community College District on June 30, 1990. The revenues received from the sale, \$2,438,209, were deposited in the School Land Bank Fund in August 1990.

PLANNED SALES 1991-92

Ocotillo Wells:

The Commission approved the sale of 4,331 acres of land in Imperial County near Anza Borrego State Park to the Department of Parks and Recreation. The purchase price is \$596,606. The patent to transfer the property is being reviewed.

U.S. Army Corps of Engineers, Sierra Army Depot:

The Commission approved the sale of 16,282 acres of land in Lassen County, to the U.S. Corps of Engineers, which has leased the site since 1942. The purchase price is \$1,303,000. The sale should be consummated, if the Corps of Engineers can appropriate funds, in the spring of 1992.

**Kern River Gas Transmission
Co. & Mojave Pipeline Co.:**

The Commission approved several leases to Kern River Gas Transmission Company and Mojave Pipeline Company for natural gas transmission pipelines and related facilities. As part of the environmental process the applicants were required to acquire mitigation lands for their projects' impacts on threatened and endangered species. The Commission negotiated the equivalent of a first right of refusal to sell school lands to fulfill the mitigation requirements. The amount of school lands being considered is approximately 10,000 acres. Negotiations are continuing regarding total acres involved and the sales should be consummated by the spring of 1992.

Scaroni Ranch:

The Department of Parks and Recreation will sell surplus property in order to raise funds to purchase Scaroni Ranch. The estimated value of the school lands is approximately \$5,000,000. Depending on the real estate market the sale could be consummated by June of 1992.

Slab City:

Staff received approval to sell a 640 acre parcel of school land, commonly referred to as "Slab City", located in Imperial County. The minimum bid price, set by staff appraisal, was \$225,391. No qualifying bids were received. Staff believes that the lack of qualifying bids was due to a continuing trespass problem.

The Commission authorized staff counsel to take all steps necessary, including litigation, to terminate the continuing unauthorized occupation of this property. Staff will market the property again once the trespass problem is solved.

Nature Conservancy:

Staff is working to sell to the Nature Conservancy 240 acres of school land near Indio for inclusion into the Dos Palmas Oasis. This area is critical habitat for migratory and resident birds. Preliminary estimates indicate a value of \$120,000. Upon completion of the appraisal, a purchase agreement will be presented to the Commission.

Bureau of Land Management (BLM):

Staff is in the final stages of completing the sale of 408 acres of school land in San Bernardino County to the BLM. This BLM acquisition will provide additional acreage to the Razor Off-Highway Vehicle Area. This sale should be completed by November 1991, and the sale revenue of \$54,600 deposited in the School Land Bank Fund.

EXCHANGES AND INDEMNITY SELECTIONS

**Barstow II Exchange (BLM lands in Homestead Valley,
San Bernardino County):**

Unless other more desirable BLM properties are identified this large exchange will be either reduced dramatically in size, or dropped completely. A physical inspection of the BLM properties indicated that they are not desirable for management.

Ward Valley Indemnity Selection: (Low Level Radioactive Disposal Site):

This proposed indemnity selection which the Commission has been asked to sell to the Dept. of Health Services to be used as a low level radioactive waste site is currently under review with respect to concerns raised by State Land Commissioners. The SLC is waiting for a response from the Secretary of Health and Welfare to letters expressing these concerns.

Phase II United States Forest Service

Negotiations have been completed between the U.S. Forest Service and SLC to exchange scattered school land parcels within National Forest boundaries for a consolidated holding of 2,274 acres of timberland in Butte County stocked with approximately 61 million board feet of timber, that has an approximate value of \$16.5 million. The Commission approved the Phase II Land Exchange at its August 12, 1991 meeting. The exchange agreement has been executed by both parties.

1991-92 Planned Exchanges and Selections:

None are planned.

SPECIAL PROJECTS

SLC/California Department of Forestry & Fire Protection (CDF)

The two-year extension to the SLC/CDF Management agreement for nine forested parcels expires June 30, 1992. During fiscal year 1990-91 CDF generated income of \$119,378 from the sale of forest products. During the coming year CDF plans one sale at Hayfork Divide with an anticipated revenue of \$43,000.

Timber Harvest Plan (THP):

CDF approved staff's THP to harvest 2.1 million board feet of timber on 175 acres of school lands in Mendocino County. The sale of the timber, with a value of \$800,000, has been delayed due to concerns of environmentalists for any timber harvesting in Mendocino County.

Salt Creek:

The Salt Creek Timber Stand Improvement Project was completed in June. Hardwoods were removed, under guidelines developed in conjunction with the Department of Fish and Game, in order to provide more growing space for residual conifers.

Fee Schedule:

Staff has developed estimates of reimbursable funding of the costs of processing the various applications and transactions relating to surface leasing. Reimbursement accounts are now being created to cover the processing costs of new project applications. This will reduce staff cost thus increasing net revenues to STRS.

New Leases - FY 1990-91:

Staff issued 5 new leases, (2 agricultural, 2 grazing and one right of way), covering 13,802 acres of School Land in 3 counties, total annual rent generated is \$53,902.

Rent Reviews - Increases 1990-91:

Staff increased rent on 4 leases and continued the same rent on 8 others during the past fiscal year. Annual rent increased from \$1,395.41 to \$2,169.00.

MINERAL RESOURCES MANAGEMENT GEOTHERMAL PROGRAM

The objective of the Geothermal Program is to manage the orderly development of geothermal resources on school lands. This is accomplished through issuance of leases and approval authority over all operations conducted on the leases. This responsibility includes optimizing steam recovery and maximizing revenue generated from resource development activities, and ensuring that such activities are consistent with public safety and environmental protection.

The only geothermal resources currently being produced from school lands are located in the Geysers Geothermal Field in Lake and Sonoma Counties, the largest geothermal development in the world. Continued declines in steam production from the field were offset by increases in steam prices during fiscal year 1990-91, so that the royalty revenue of \$4.17 million nearly equaled the previous year's total.

The Geysers:

No new wells were completed on State leases at The Geysers during fiscal year 1990-91. There were, however, three new wells completed on private lands, and eight new wells on Federal lands, with four more being drilled at the end of the year. The lack of drilling on State leases reflects the unfavorable economics of drilling new wells in light of declining steam reserves and declining reservoir pressures throughout much of the field. Of the 15 new wells mentioned above, all were drilled by either Santa Fe, Calpine, or NCPA. These operators enjoy steam prices notably higher than those paid by PG&E to Unocal, the state's primary lessee of geothermal school lands. Unocal has not drilled a new well in the past two years, nor has Coldwater Creek Operator Corp (CCOC), the State's second largest source of geothermal royalty revenue. Financial difficulties are to blame for CCOC's lack of drilling activity.

Corrosion and Contaminant Problems:

Corrosion problems associated with high chloride content in steam produced in the Northwest Geysers, including State leases, were less of a problem during fiscal year 1990-91 than the previous year. Wellhead corrosion mitigation equipment installed by the operators appears to be successful in decreasing downtime due to pipeline failures.

Non-condensable gases are a contaminant that is a problem in certain parts of the field because concentration levels exceed the design limits of the power plants. There is at least one well on a State lease in the Northwest Geysers that cannot be connected to a power plant because the non-condensable gas content is too high. Staff continues to work with operators to evaluate technical solutions to the corrosion and steam contaminant problems.

Royalty Revenue and Steam Prices:

In fiscal year 1990-91, geothermal royalty totalled \$4,170,194. This included approximately \$3,362,836 from Unocal leases, \$646,693 from CCOC leases, and \$160,665 from the Calpine lease.

Royalty revenue is a function of steam production, which continues to decline, and steam prices, which continue to rise. Production from Unocal leases decreased about 6% from the previous fiscal year, while production from CCOC leases and the Calpine lease decreased about 15% and 8%, respectively.

The price PG&E pays Unocal for steam used to generate electricity increased from \$15.84 per megawatt-hour in 1990 to \$16.22 in 1991, a 2% increase. The PG&E price translates to about \$0.81 per thousand pounds. Prices on the CCOC leases and the Calpine lease increased by about 6% to \$1.94 and \$2.10 per thousand pounds, respectively.

The profound difference between the price PG&E pays for steam and what others pay is due to the circumstances under which the older PG&E contracts were negotiated. Since PG&E pays on a net megawatt-hour basis, rather than on the amount of steam delivered, there is no incentive for PG&E to make plant modifications that would result in a more efficient utilization of available steam resources. PG&E plants are generally less efficient than other power plants at The Geysers. This is a matter that staff is aggressively pursuing through its involvement in the Technical Advisory Committee and in discussions with Unocal regarding possible changes in their steam sales agreement with PG&E.

Lawrence Berkeley Laboratory Study:

Lawrence Berkeley Laboratory (LBL), under contract to SLC, continued its analysis and reservoir modeling of The Geysers during fiscal year 1990-91. Under direction of SLC staff, development of a three-dimensional model of the Northwest Geysers was initiated in cooperation with CCOC. This model allows detailed estimation of steam drainage in the area and will help optimize steam recovery and determine the resource potential of unleased school land parcels for future leasing. Work began on using a computer model to obtain a conceptual understanding of the high temperature reservoir (HTR) in the Northwest Geysers. LBL also began analyzing geochemical data to determine the amount of liquid reserves at The Geysers.

This work is a part of the development of a reservoir management plan for The Geysers area which include the State leases. This reservoir management plan will be developed using the three-dimensional reservoir model for evaluating different reservoir management scenarios. In particular, the effects of enhanced water injection to increase steam production will be investigated. The U.S. Department of Energy has matched SLC funding in expanding this research program.

Geysers Technical Advisory Committee:

SLC was an active participant in The Geysers Technical Advisory Committee (TAC) during fiscal year 1990-91. The TAC consists of representatives of The Geysers steam field operators, power plant operators, mineral owners and State and Federal regulatory agencies. The TAC hired consultants to investigate the currently available reservoir models of The Geysers developed by LBL and Unocal, and to investigate appropriate power plant modifications to increase efficiency. This work has progressed slowly and may not yield useful results in the short term. However, SLC staff, along with staffs of the Energy Commission and the Lake County Planning Department, are attempting to encourage reluctant participants to cooperate more fully and accelerate the program.

1991-92 PLANS

Future Prices and Revenue:

The proposed settlement of opposing lawsuits between Unocal and PG&E has yet to be finalized. This settlement may significantly modify field operation procedures and the formula used to determine future steam prices. Certain terms of this settlement will require the approval of SLC and the Public Utilities Commission. Forecasts made by staff indicate that the new formula will result in higher steam prices than those used under the old formula, and changes in field operations could affect the level of future royalty revenue.

Future steam prices are expected to continue rising slowly. Higher prices will partially offset a continued decline in steam production. Royalty revenue from existing leases is expected to total \$4.2 million for fiscal year 1991-92. No revenue from net profits sharing provisions is expected in the near future.

Future Leasing:

During fiscal year 1990-91, staff assisted Chambers Group, Inc. in the preparation of a programmatic environmental impact report (EIR) on proposed leasing of unleased school lands parcels, primarily in the undeveloped northwest part of The Geysers. The Draft EIR should be ready for release before the end of 1991. Offering of leases for competitive bid could occur in 1992. Development would be at least one or more years after that depending on whether a new plant needs to be constructed or steam lines can be connected to existing plants.

MINERAL RESOURCES MANAGEMENT MINERAL PROGRAM

Permits:

During fiscal year 1990-91 staff issued five prospecting permits on school lands for gold and silver. Currently, there are a total of nine active prospecting permits on school lands. Successful reconnaissance work on two permits has encouraged the permittees to apply for amendments to the existing permits authorizing exploratory drilling for gold mineralization.

Leases:

At the end of fiscal year 1990-91 there were five active mineral extraction leases and one pending application. Revenue from the existing industrial mineral and aggregate leases declined during the year because of the nationwide economic downturn in manufacturing and building. Hard mineral revenue for fiscal year 1990-91 totaled \$68,102.

Minerals Management:

Staff met with staff of the Western Mineral Resources Branch of the United States Geological Survey (USGS) to discuss a study in preparation by the USGS for a mineral resource assessment on portions of the Mojave Desert. The assessment will develop a probability or statistical model for undiscovered ore bodies that may exist within the study area. The area of this study will include some school lands parcels in the eastern Mojave. The statistical inferences to possible undiscovered ore bodies within the school lands could be an extremely important management tool. The study is scheduled for release in late 1991.

Cost Recovery:

In coordination with new agency policy, the staff has developed estimates for reimbursable funding of the costs of processing the various applications and transactions related to mineral resources and the mineral estates. Reimbursement accounts are now being created to cover the processing costs required for new applications. Over \$9,000 is currently on deposit for projects in-house. Full implementation of the reimbursement policy will lower mineral management costs thereby increasing the net return from mineral revenues to the State Teachers Retirement Fund.

Oil and Gas Activities:

The single oil and gas lease on state school lands (with a 1/16th interest) continued to produce revenue during fiscal year 1990-91. This Kern County lease first produced oil in 1928. Oil and gas revenue during fiscal year 1990-91 increased to over \$26,768.

1991-92 Plans:

Staff is processing a total of eight new prospecting permit applications for school lands sections. The application for a mineral extraction lease is waiting completion of the environmental review and permitting of the project by the Bureau of Land Management and San Bernardino County. Contacts with the USGS will continue regarding the California Desert mineral assessment study. The information that comes from the study may influence land exchange proposals under pending Mojave Desert Protection legislation. Cost control efforts and reimbursement of staff costs for processing public applications will continue and be expanded.

LEGISLATION

Pending Federal Legislation:

H.R.701: Thomas: "Elk Hills"

H.R.701 authorizes the President to lease Naval Petroleum Reserve Number 1, (Elk Hills) and thereby assure the efficient production of oil, natural gas and other hydrocarbon resources at that property; to ensure the Federal Government receives fair market value for leasing the property; to upgrade the Nation's energy security assets by establishing a defense petroleum inventory; and to provide with the equitable sharing with the State of California revenues from Naval Petroleum Reserve Number 1.

H.R.701 also provides that any leasing action under this act shall require a royalty payment equal to not less than 12.5 percent of the value, as determined by the President or his designee, of the oil, natural gas, and other hydrocarbon resources of the production removed or sold from the lease be paid to the Naval Petroleum Reserve Lease Proceeds Special Account.

H.R. 2929: Lehman-Levine-Miller: "California Desert Protection Act"

The California Desert Protection Act of 1991 would establish a new Mojave National Monument, add additional lands to existing Death Valley and Joshua Tree National Monuments and designate them as National Parks, and would designate additional wilderness areas in the California Desert Conservation Area. A Land Exchange Selection List was completed for incorporation into H.R. 2929. This list identifies existing BLM leased land with geothermal, oil, and gas, and hard rock mineral resources for the Commission to receive in exchange for 627 school land parcels totalling 327,000 acres within the potential Federal California Desert Protection Act.

The Desert Protection Act proposal includes wildernesses previously deleted from S.21 and deletes some included previously within S.21, making a net change of about 31,000 acres out of 8 million. This bill does contain Section 607 which was requested for inclusion by the SLC. A hearing was held by the Interior Subcommittee on the California Desert chaired by Congressman Rick Lehman on September 16, 1991. Mark-up by the subcommittee and action by the full committee is anticipated this fall.

H.R.3066: Lewis: Bush Administration: "California Public Lands Wilderness Act"

H.R.3066 is the Department of Interior's California Desert proposal. It is a much smaller proposal, affecting 195 school lands parcels totalling 100,000 acres. This bill does not contain a specific "State Exchange" provision.

S.21: Cranston: "California Desert Protection Act"

S.21 is the companion bill in the Senate to H.R. 2929, the "California Desert Protection Act." The bill would provide for the protection of public lands in the California desert. Senator Cranston has carried similar legislation over the last five years. This bill is not currently moving. SLC has received a report prepared by Williams-Kuebelbeck and Associates, Inc. placing the surface value of state lands affected by S.21 at approximately \$36 million. SLC has proposed that mineral values be appraised on an "income" approach. If mineral values exceed those of surface values, then mineral values will be used in place of surface values.

S.570: Johnston: "The National Energy Strategy Act"

S. 570 provides that if the President finds that control and use of Naval Petroleum Reserve Numbered 1 by the United States is not necessary for national defense purposes or to assure their exploration, development and operation, the President may lease any or all of that reserve.

Enacted State Legislation:

A.B.222: Vasconcellos: "Budget Bill"

A.B.222 provides for the transfer by the State Controller of \$7 million from the School Land Bank Fund to the General Fund. The SLC is investigating the legality of the transfer and analyzing the various courses of action which can be taken in response to AB222. Upon obtaining a legal opinion from private outside counsel, the Commission will take a strong and appropriate stand regarding the transfer.

The SLC is also investigating options which could prevent a repeat of this year's loss. Among those options under review are investing fund moneys in commingled funds, real estate investment trusts, and real estate mutual funds. The return and liquidity of these options are being reviewed. Most of these options can be entered with far less money than direct investment. On the other hand, to get into institutional quality properties still requires the collection of some millions of dollars for highest return.

LITIGATION

Elk Hills:

The state asserts legal title and possession to two school sections in the Elk Hills Naval Petroleum Reserve. Litigation and negotiations are still proceeding. Revenue from these two producing sections is utilized to augment the federal treasury, thus terminating the reserve status under the provisions of the Jones Act. The Commission also contends that it has an equitable title interest in two school sections, and that the federal government has trust obligations to protect that interest.

Geothermal Resources International:

The Bankruptcy case of Geothermal Resources International, Inc. (GRI), the lease holder of three parcels at the Geysers, is still in court. Staff counsel expects that GRI will quitclaim the lease back to SLC, or assign the lease. The case should be resolved by the end of 1991 or Spring of 1992.

FINANCIAL SUMMARY

Expenses and Revenues

Revenue:	Year-to-Date
Surface Rentals	\$305,047
Geothermal	4,170,194
Oil and Gas	26,768
Minerals	68,102
Timber	<u>329,378</u>
TOTAL: Gross Revenues	\$4,899,489
less; Geothermal Resources Development Account Deposits	(\$143,703)
(Public Resources Code Section 3826)	
TOTAL; School Lands Revenues (Subject to PRC 6217.5)	\$4,755,786
Net Management Costs:	
Land Management	\$915,725
Geothermal	498,694
Oil and Gas	31,460
Minerals	120,908
Ownership Determination	<u>36,091</u>
Total; Gross Expenditures	\$1,602,878
less; Reimbursement Recovery	(\$222,415)
TOTAL; Net Expenditures	\$1,380,463
TOTAL; NET REVENUES TO TEACHERS RETIREMENT FUND	\$3,375,323

SCHOOL LAND BANK FUND

Balance as of June 30, 1990	\$4,150,750
Deposits fiscal year 90-91	2,578,209
Interest fiscal year 90-91	504,158
Administrative Expenses	(\$54,664)
Total Balance as of June 30, 1991	\$7,178,453