



RSF CONNECT PROJECT UPDATE

Construction Firm Selected, Budget Finalized, Financing Committed

July 30, 2018

Dear Member,

We are ready to break ground on our underground fiber-optic network, bringing 1-gigabit-per-second internet service to homeowners and businesses in the Covenant. The Association will pay for construction and will own the fiber backbone and the central office as well as pay for certain operating expenses to maintain the network. Our internet service provider (ISP) will install, own and operate the electronics in the central office and install modems, connect homes to the network and serve customers of RSF Connect.

Today the Association Board of Directors selected HP Communications to construct our network. In April the Board contracted with Race Communications as our ISP. Both selections were made after the Board, Audit/Finance Committee, Technology Committee, project consultants and Association staff requested proposals from several qualified companies, reviewed bids, interviewed contractors, evaluated risks and checked references to ensure that the best construction contractor and ISP for this project and our community were chosen. Based on HP's proposal, construction is expected to begin in August and be completed in approximately 12 months.

HP Communications

We selected HP to construct the network for several reasons, including a lower bid price, relevant project experience, previous work in Rancho Santa Fe and with the County of San Diego, a proven track record working with Race, responsiveness and enthusiasm for the project.

Our contract with HP is an industry-standard unit-cost arrangement, meaning our cost will be based on the actual length of network, trenching locations and methods and cost of materials. The budget for the project is based on the completed engineering design and provides for \$15 million to be paid to HP for network construction. The final cost of the project could be lower or higher due to changes in the actual route and methodology employed and the cost of materials. For example, some property owners on shared private roads may decline installation of fiber on their roads, shortening the network and decreasing the cost. Additionally, if trenching in some areas were moved from the street to off-pavement areas where trenching is more economical, the cost would decrease. Conversely, cost would increase if rerouting extended the length of the network or if trenching was moved from off-pavement areas onto the street. The Association has the right to determine the route, methods of construction and materials to be used.

The final engineering design does not include possible additional trenching and patching that the County may require in certain cases if the engineered route is too close to the side of the road. Similarly, the contract with HP assigns to the Association the risk of certain unknown conditions, such as extraordinary subsurface conditions, and other unforeseen circumstances, such as new County permits or route requirements or unanticipated County repaving. To provide for such unknowns, we have allocated \$1.6 million for contingencies in addition to the \$15 million construction cost.

Total Project Cost

Based upon the final engineering design, physical inspections by bidders and the contract with HP, the total project cost is budgeted to be:

Construction of Fiber-Optic Backbone	\$ 15.0 million
Construction of Central Office	0.4
Installation of Fiber from Terminals to Property Lines (50% of all residences)	0.4
Engineering, Consulting and Legal Costs	0.9
County Permits and Inspections	0.7
Contingency Allowance	1.6
Total	<u>\$ 19.0 million</u>

The preliminary cost estimate of \$14 million used for last year's community advisory vote was based on a preliminary engineering design. The increase to the current budgeted cost is due to:

1. Length of network (impact: \$2.4 million) — The final engineering design and budget includes approximately 13 additional miles of fiber installed in private roads, which were not identified in the preliminary design or included in the preliminary cost estimate.
2. Construction costs (impact: \$1.2 million) — A sharp increase in the number of utility construction projects over the past year has resulted in increased labor rates and material costs.
3. Installation of fiber from terminals to property lines (impact: \$0.4 million) — The preliminary estimate did not include the installation of fiber from terminal locations along the route to "flower pots" (service points) near property lines that direct fiber to individual homes. The budget assumes that 50% of homeowners will subscribe to the network by December 31, 2019, the date after which the Association will no longer be obligated to pay this cost.
4. Contingency allowance (impact: \$0.6 million) — An increased understanding of the variable nature of the construction contract, potential County requirements for more expensive trenching and patching near the side of the road, unknown conditions or unforeseen circumstances resulted in an contingency allowance of \$1.6 million, or about 10% of budgeted construction cost.
5. Other (impact: \$0.4 million) — Refined estimates for engineering, consulting and legal expenses and for insurance and performance bonds have been incorporated in the budget.

Race Communications

We selected Race as our ISP based on the company's 20-plus years of success in providing internet connectivity via fiber in California, Race's comprehensive programming and its connection strategy providing a more reliable method of connection to our central office. The contract with Race contains performance standards for network reliability, speed and customer service, network monitoring, billing and other administrative services. Race will supply internet, television and telephone services to homes and businesses in the Covenant at the following monthly prices:

1-gigabit (upload and download speed) internet:	\$135 per month
Television, up to 300 channels	\$98 per month
Telephone with unlimited calling within the U.S.	\$10 per line per month

Of the internet subscription fee of \$135 per month, \$70 will be retained by the ISP and \$65 will be remitted to the Association as a "recovery fee."

Financing of Project Cost

We will finance the project with \$8 million from the Fiber-Optic Fund and \$11 million of bank financing. A proposal for the bank financing has been obtained for a 10-year, fully-amortizing loan at a fixed rate of 4.05%. The Association will repay the loan and satisfy cash flow requirements with a portion of annual assessments (2.5 of 14 cents/\$100 of assessed value) and the \$65 per month recovery fee. Based on current projections, assessments will not be increased above the current 14 cents/\$100 of assessed value as the result of this project, and there will be no special assessment to fund the project.

We have projected how ongoing assessments and recovery fees will satisfy repayment of the loan and other cash flow requirements. The annual debt service of the loan is projected based on the bank proposal. As

subscription levels increase over time, the use of ongoing assessments will decrease. The number of subscribers assumed by the model below has been based on the overwhelming 83% positive response to the advisory vote and the continued member enthusiasm for the project. The model assumes the following:

Total Cost of Project	\$19 million	
Bank Financing	\$11 million	
Annual Debt Service	\$1.3 million	
Annual Operating Costs	\$385,000 (year 1) to \$236,000 (year 10)	
Annual Additions to Reserves	\$10,000	
Monthly Subscription Price for 1-Gigabit Service	\$135	
Percentage (number) of Subscribers:		
	<u>Residential</u>	<u>Business</u>
Year 1	35% (642)	35% (21)
Year 2	50% (918)	39% (23)
Year 3	59% (1084)	42% (25)
Year 4 and thereafter	65% (1192)	43% (26)

Using the above assumptions, use of the 2.5 cents/\$100 of assessed value portion of the annual assessment and recovery fees necessary to repay the loan and to satisfy other cash flow requirement are estimated to be:

	<u>2.5 Cent Portion of Assessment</u>	<u>Recovery Fee</u>
Year 1	\$ 1,100,000	\$ 517,000
Year 5	661,000	950,000
Year 10	598,000	950,000
Year 11 (after loan has been repaid)	0	247,000

When the loan is repaid in year 10, the 2.5 cents portion of the annual assessment will no longer be needed to support the project and only \$247,000 of the \$950,000 recovery fees to be charged will be used for annual operating costs and additions to reserves.

RSF Connect Cost for Homeowners

We will fund construction of the fiber network on all County roads within the Covenant and on shared private roads with respect to which licensing agreements are finalized with the Association by December 31, 2018. If agreements are finalized after December 31, 2018, homeowners on those shared private roads will be responsible for the entire cost of construction on their roads at then-prevailing rates.

If prior to December 31, 2019, a homeowner subscribes to internet service, the cost of fiber installation from the terminal location to the “flower pot” near the property line of their building site will be paid by the Association. All subscribers will pay for bringing a fiber cable from the flower pot to their individual homes, including installing new conduit piping from the flower pot to the home or extending existing conduit to the flower pot.

Homeowners may work with Race or another contractor to install or extend their conduit. If a homeowner subscribes to RSF Connect prior to December 31, 2019, Race has priced the cost to homeowners of installing or extending the conduit in most cases at \$6.25 per linear foot. Race will charge a one-time \$250 connection fee which will be waived if a homeowner signs a three-year service agreement. Homeowners will also be responsible for the cost to install or upgrade existing equipment/wiring within their homes to take full advantage of the 1-gigabit service. A homeowner who subscribes after December 31, 2019, must pay the cost of installing fiber from the terminal location to the flower pot and from the flower pot to the home at then-prevailing rates. All members are reminded to sign up early for service to receive installation cost benefits.

The Construction Process

The Association has worked closely with the County to obtain support and approval of the RSF Connect project. The County provided “conceptual” approval and continues to work cooperatively with the Association on the project and construction methods. The Association has now obtained all required permits.

HP will construct the network using newer technology called narrow trenching in which small 3-inch cuts are made in the road or off-pavement, the conduit pipe is placed into the trenches and the trench is filled and patched. This construction method allows for the cutting, laying of the conduit and backfill to be done in a very rapid sequence. This way, only short segments of roadway will have to be closed for construction, minimizing traffic delays and detours. A traffic control flag team will typically need to close only a single lane of a two-lane road during trenching. Our goal is to construct the network as quickly as possible while minimizing road closures and inconvenience for our members.

The County requires use of off-pavement areas for construction work to avoid newly paved roads because of its “no-cut” policy on roads paved within three years. Since the County has several roads identified for repaving in the next couple of years, we will move rapidly to first install the fiber before these roads are repaved. This requirement will affect our construction sequence and strategy.

Members will be notified of construction progress and road closures via the weekly email newsletter and the Association website (www.rsffassociation.org). We will provide online maps showing the progress as well as scheduled road closures and detours in an effort to keep you up to date and minimize inconveniences due to construction.

Next Steps

In coming weeks, you will be contacted by Race about bringing service to your home. To take advantage of cost savings, please sign up for service as soon as possible and plan to have any necessary conduit installed on your property. It is critical that homeowners who live on shared private roads complete a licensing agreement with the Association as soon as possible to permit construction on those roads and avoid additional cost.

If you have any questions about this project, please contact the Association at RSFA@RSFAssociation.org or 858-756-1174. Please visit www.RSFConnect.com for future information about project construction, schedule, subscriptions and more. Our goal is to keep you up to date as we build this important community asset for our members.

We are among the first communities in the nation to build our own network. RSF Connect will offer our community an essential amenity providing enhanced safety, added convenience and a better quality of life. As a result, it will improve the attractiveness of the Covenant and provide homeowners higher home values. Let’s join together as a community and make the project an overwhelming success by working with Race to install conduit on our properties and indicating early that we want to subscribe and support to our own fiber-optic network.

Sincerely,

The Rancho Santa Fe Association
by the Rancho Santa Fe Board of Directors