UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2019

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period From _____ to _____

Commission file number: 001-36309

INOGEN, INC.

(Exact name of registrant as specified in its charter)

Delaware	**33-0989359**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
326 Bollay Drive Goleta, CA	**93117**
(Address of principal executive offices)	**(Zip Code)**

Registrant's telephone number, including area code: (805) 562-0500

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.001 par value	**INGN**	**The NASDAQ Stock Market LLC (NASDAQ Global Select Market)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
Emerging growth company	☐		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of July 31, 2019, the registrant had 21,933,758 shares of common stock, par value $0.001, outstanding.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Inogen, Inc.
Consolidated Balance Sheets
(amounts in thousands)

	June 30, 2019	December 31, 2018
	(unaudited)	
Assets		
Current assets		
Cash and cash equivalents	$ 213,947	$ 196,634
Marketable securities	42,202	43,715
Accounts receivable, net	46,721	37,041
Inventories, net	24,485	27,071
Deferred cost of revenue	352	359
Income tax receivable	2,750	2,655
Prepaid expenses and other current assets	10,269	7,108
Total current assets	340,726	314,583
Property and equipment		
Rental equipment, net	40,587	43,038
Manufacturing equipment and tooling	9,034	7,338
Computer equipment and software	6,943	6,153
Furniture and equipment	1,463	1,445
Leasehold improvements	3,595	3,407
Land and building	125	125
Construction in process	2,616	3,128
Total property and equipment	64,363	64,634
Less accumulated depreciation	(43,002)	(42,293)
Property and equipment, net	21,361	22,341
Goodwill	2,242	2,257
Intangible assets, net	3,127	3,755
Operating lease right-of-use asset	5,461	—
Deferred tax asset - noncurrent	26,063	30,130
Other assets	4,793	2,832
Total assets	$ 403,773	$ 375,898

See accompanying condensed notes to the consolidated financial statements.

Inogen, Inc.
Consolidated Balance Sheets (continued)
(amounts in thousands, except share and per share amounts)

	June 30, 2019	December 31, 2018
	(unaudited)	
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable and accrued expenses	$ 27,325	$ 26,786
Accrued payroll	6,969	11,407
Warranty reserve - current	4,036	3,549
Operating lease liability - current	2,006	—
Deferred revenue - current	5,616	4,451
Income tax payable	410	392
Total current liabilities	46,362	46,585
Long-term liabilities		
Warranty reserve - noncurrent	6,289	5,981
Operating lease liability - noncurrent	4,456	—
Deferred revenue - noncurrent	12,638	11,844
Deferred tax liability - noncurrent	230	232
Other noncurrent liabilities	—	832
Total liabilities	69,975	65,474
Commitments and contingencies (Note 9)		
Stockholders' equity		
Common stock, $0.001 par value per share; 200,000,000 authorized; 21,933,669 and 21,778,632 shares issued and outstanding as of June 30, 2019 and December 31, 2018, respectively	22	22
Additional paid-in capital	257,177	249,194
Retained earnings	75,946	60,484
Accumulated other comprehensive income	653	724
Total stockholders' equity	333,798	310,424
Total liabilities and stockholders' equity	$ 403,773	$ 375,898

See accompanying condensed notes to the consolidated financial statements.

Inogen, Inc.
Consolidated Statements of Comprehensive Income
(unaudited)
(amounts in thousands, except share and per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2019	**2018**	**2019**	**2018**
Revenue				
Sales revenue	$ 95,863	$ 91,987	$ 180,681	$ 165,571
Rental revenue	5,200	5,251	10,584	10,718
Total revenue	101,063	97,238	191,265	176,289
Cost of revenue				
Cost of sales revenue	47,230	44,968	89,297	81,916
Cost of rental revenue, including depreciation of $1,594 and $1,966, for the three months ended and $3,299 and $4,131 for the six months ended, respectively	3,618	3,800	7,344	8,176
Total cost of revenue	50,848	48,768	96,641	90,092
Gross profit				
Gross profit-sales revenue	48,633	47,019	91,384	83,655
Gross profit-rental revenue	1,582	1,451	3,240	2,542
Total gross profit	50,215	48,470	94,624	86,197
Operating expense				
Research and development	1,468	1,775	3,137	3,191
Sales and marketing	27,758	22,999	55,959	41,037
General and administrative	8,844	9,675	18,525	19,248
Total operating expense	38,070	34,449	77,621	63,476
Income from operations	12,145	14,021	17,003	22,721
Other income (expense)				
Interest income	1,394	673	2,728	1,216
Other income (expense)	145	(1,048)	25	(604)
Total other income (expense), net	1,539	(375)	2,753	612
Income before provision (benefit) for income taxes	13,684	13,646	19,756	23,333
Provision (benefit) for income taxes	3,524	(964)	4,294	(2,035)
Net income	10,160	14,610	15,462	25,368
Other comprehensive income (loss), net of tax				
Change in foreign currency translation adjustment	106	76	(31)	184
Change in net unrealized gains (losses) on foreign currency hedging	(618)	723	(534)	474
Less: reclassification adjustment for net (gains) losses included in net income	282	(103)	458	69
Total net change in unrealized gains (losses) on foreign currency hedging	(336)	620	(76)	543
Change in net unrealized gains (losses) on marketable securities	23	19	36	—
Total other comprehensive income, net of tax	(207)	715	(71)	727
Comprehensive income	$ 9,953	$ 15,325	$ 15,391	$ 26,095
Basic net income per share attributable to common stockholders (Note 6)	$ 0.47	$ 0.69	$ 0.71	$ 1.20
Diluted net income per share attributable to common stockholders (Note 6)	$ 0.45	$ 0.65	$ 0.69	$ 1.13
Weighted-average number of shares used in calculating net income per share attributable to common stockholders:				
Basic common shares	21,815,634	21,172,170	21,783,150	21,099,566
Diluted common shares	22,359,679	22,503,749	22,459,101	22,409,011

See accompanying condensed notes to the consolidated financial statements.

Inogen, Inc.
Consolidated Statements of Stockholders' Equity
(amounts in thousands, except share amounts)

	Three months ended June 30, 2019 and June 30, 2018					
	Common stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total stockholders' equity
	Shares	Amount				
Balance, March 31, 2018 (unaudited)	21,214,662	$ 21	$ 226,635	$ 19,397	$ 284	$ 246,337
Stock-based compensation	—	—	3,186	—	—	3,186
Vesting of restricted stock units	459	—	—	—	—	—
Stock options exercised	106,422	—	2,058	—	—	2,058
Net income	—	—	—	14,610	—	14,610
Other comprehensive income	—	—	—	—	715	715
Balance, June 30, 2018 (unaudited)	21,321,543	$ 21	$ 231,879	$ 34,007	$ 999	$ 266,906
Balance, March 31, 2019 (unaudited)	21,931,342	$ 22	$ 255,226	$ 65,786	$ 860	$ 321,894
Stock-based compensation	—	—	1,779	—	—	1,779
Employee stock purchases	—	—	—	—	—	—
Restricted stock awards issued, net of forfeitures	(12,342)	—	—	—	—	—
Vesting of restricted stock units	10,111	—	(8)	—	—	(8)
Shares withheld related to net restricted stock settlement	(978)	—	(63)	—	—	(63)
Stock options exercised	5,536	—	243	—	—	243
Net income	—	—	—	10,160	—	10,160
Other comprehensive income	—	—	—	—	(207)	(207)
Balance, June 30, 2019 (unaudited)	21,933,669	$ 22	$ 257,177	$ 75,946	$ 653	$ 333,798

	Six months ended June 30, 2019 and June 30, 2018					
	Common stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total stockholders' equity
	Shares	Amount				
Balance, December 31, 2017	20,976,350	$ 21	$ 218,109	$ 8,639	$ 272	$ 227,041
Stock-based compensation	—	—	6,567	—	—	6,567
Employee stock purchases	12,013	—	988	—	—	988
Restricted stock awards issued	53,052	—	—	—	—	—
Vesting of restricted stock units	6,665	—	—	—	—	—
Shares withheld related to net restricted stock settlement	(2,553)	—	(302)	—	—	(302)
Stock options exercised	276,016	—	6,517	—	—	6,517
Net income	—	—	—	25,368	—	25,368
Other comprehensive income	—	—	—	—	727	727
Balance, June 30, 2018 (unaudited)	21,321,543	$ 21	$ 231,879	$ 34,007	$ 999	$ 266,906
Balance, December 31, 2018	21,778,632	$ 22	$ 249,194	$ 60,484	$ 724	$ 310,424
Stock-based compensation	—	—	5,365	—	—	5,365
Employee stock purchases	16,767	—	1,525	—	—	1,525
Restricted stock awards issued, net of forfeitures	54,602	—	—	—	—	—
Vesting of restricted stock units	21,376	—	(67)	—	—	(67)
Shares withheld related to net restricted stock settlement	(13,023)	—	(718)	—	—	(718)
Stock options exercised	75,315	—	1,878	—	—	1,878
Net income	—	—	—	15,462	—	15,462
Other comprehensive income	—	—	—	—	(71)	(71)
Balance, June 30, 2019 (unaudited)	21,933,669	$ 22	$ 257,177	$ 75,946	$ 653	$ 333,798

See accompanying condensed notes to the consolidated financial statements.

Inogen, Inc.
Consolidated Statements of Cash Flows
(unaudited)
(amounts in thousands)

	Six months ended June 30,	
	2019	**2018**
Cash flows from operating activities		
Net income	$ 15,462	$ 25,368
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	5,554	5,809
Loss on rental units and other fixed assets	323	525
Gain on sale of former rental assets	(46)	(401)
Provision for sales revenue returns and doubtful accounts	8,890	9,942
Provision for rental revenue adjustments	1,227	1,429
Provision for inventory losses	410	227
Stock-based compensation expense	5,365	6,567
Deferred income taxes	4,067	(2,100)
Changes in operating assets and liabilities:		
Accounts receivable	(19,735)	(17,480)
Inventories	1,536	(9,070)
Deferred cost of revenue	7	(20)
Income tax receivable	(95)	(1,346)
Prepaid expenses and other current assets	(3,161)	(4,084)
Operating lease right-of-use asset	(5,461)	—
Other noncurrent assets	(1,926)	(104)
Accounts payable and accrued expenses	223	10,830
Accrued payroll	(4,436)	2,235
Warranty reserve	795	2,559
Deferred revenue	1,959	2,161
Income tax payable	15	7
Operating lease liability	6,462	—
Other noncurrent liabilities	(832)	209
Net cash provided by operating activities	16,603	33,263
Cash flows from investing activities		
Purchases of marketable securities	(38,601)	(39,312)
Maturities of marketable securities	40,150	28,235
Investment in intangible assets	(31)	—
Investment in property and equipment	(1,973)	(4,541)
Production and purchase of rental equipment	(1,481)	(2,447)
Proceeds from sale of former assets	104	619
Net cash used in investing activities	(1,832)	(17,446)

(continued on next page)

See accompanying condensed notes to the consolidated financial statements.

Inogen, Inc.
Consolidated Statements of Cash Flows (continued)
(unaudited)
(amounts in thousands)

	Six months ended June 30,	
	2019	**2018**
Cash flows from financing activities		
Proceeds from stock options exercised	1,878	6,517
Proceeds from employee stock purchases	1,525	988
Payment of employment taxes related to release of restricted stock	(785)	(302)
Net cash provided by financing activities	2,618	7,203
Effect of exchange rates on cash	(76)	371
Net increase in cash and cash equivalents	17,313	23,391
Cash and cash equivalents, beginning of period	196,634	142,953
Cash and cash equivalents, end of period	$ 213,947	$ 166,344
Supplemental disclosures of cash flow information		
Cash paid during the period for income taxes, net of refunds received	$ 208	$ 1,631
Supplemental disclosure of non-cash transactions		
Property and equipment in accounts payable and accrued liabilities	$ 242	$ 204

See accompanying condensed notes to the consolidated financial statements.

Inogen, Inc.
Condensed Notes to the Consolidated Financial Statements
(unaudited)
(amounts in thousands, except share and per share amounts)

1. Business overview

Inogen, Inc. (Company or Inogen) was incorporated in Delaware on November 27, 2001. The Company is a medical technology company that primarily develops, manufactures and markets innovative portable oxygen concentrators used to deliver supplemental long-term oxygen therapy to patients suffering from chronic respiratory conditions. Traditionally, these patients have relied on stationary oxygen concentrator systems for use in the home and oxygen tanks or cylinders for mobile use, which the Company calls the delivery model. The tanks and cylinders must be delivered regularly and have a finite amount of oxygen, which requires patients to plan activities outside of their homes around delivery schedules and a finite oxygen supply. Additionally, patients must attach long, cumbersome tubing to their stationary concentrators simply to enable mobility within their homes. The Company's proprietary Inogen One® systems concentrate the air around the patient to offer a single source of supplemental oxygen anytime, anywhere with a single battery and can be plugged into an outlet when at home, in a car, or in a public place with outlets available. The Company's Inogen One systems reduce the patient's reliance on stationary concentrators and scheduled deliveries of tanks with a finite supply of oxygen, thereby improving patient quality of life and fostering mobility.

Since adopting the Company's direct-to-consumer rental strategy in 2009, the Company has directly sold or rented more than677,000 of its Inogen oxygen concentrators as of June 30, 2019.

The Company incorporated Inogen Europe Holding B.V., a Dutch limited liability company, on April 13, 2017. On May 4, 2017, Inogen Europe Holding B.V. acquired all issued and outstanding capital stock of MedSupport Systems B.V. (MedSupport) and began operating under the name Inogen Europe B.V. The Company merged Inogen Europe Holding B.V. and Inogen Europe B.V. on December 28, 2018. Inogen Europe B.V. is the remaining legal entity.

2. Basis of presentation and summary of significant accounting policies

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on February 26, 2019. There have been no significant changes in the Company's accounting policies from those disclosed in its Annual Report on Form 10-K filed with the SEC on February 26, 2019.

Basis of consolidation

The consolidated financial statements include the accounts of Inogen, Inc. and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated.

Use of estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Management bases these estimates and assumptions upon historical experience, existing and known circumstances, authoritative accounting pronouncements and other factors that management believes to be reasonable. Significant areas requiring the use of management estimates relate to revenue recognition and determining the stand-alone selling price (SSP) of performance obligations, inventory and rental asset valuations and write-downs, accounts receivable allowances for bad debts, returns and adjustments, warranty expense, stock compensation expense, depreciation and amortization, income tax provision and uncertain tax positions, fair value of financial instruments, and fair value of acquired intangible assets and goodwill. Actual results could differ from these estimates.

Leases

The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use (ROU) assets, operating lease liability - current, and operating lease liability - noncurrent on the consolidated balance sheets.

ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. The Company uses an incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments as the rate implicit in each lease is generally not readily determinable. The operating lease ROU asset also includes any lease payments made to the lessor at or before the commencement dateand excludes lease incentives. Lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

The Company has lease agreements with lease and non-lease components. The Company elected the practical expedient to treat the lease and non-lease components as a single lease component. Additionally, the Company elected the practical expedient to not record leases with an initial term of 12 months or less on the consolidated balance sheets.

Revenue

The Company generates revenue primarily from sales and rentals of its products. The Company's products consist of its proprietary line of oxygen concentrators and related accessories. Other revenue, which is included in sales revenue on the Statements of Comprehensive Income, primarily comes from service contracts, replacement parts and freight revenue for product shipments.

Sales revenue

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. Revenue from product sales is generally recognized upon shipment of the product but is deferred for certain transactions when control has not yet transferred to the customer.

The Company's product is generally sold with a right of return and the Company may provide other incentives, which are accounted for as variable consideration when estimating the amount of revenue to recognize. Returns and incentives are estimated at the time sales revenue is recognized. The provisions for estimated returns are made based on known claims and estimates of additional returns based on historical data and future expectations. Sales revenue incentives within the Company's contracts are estimated based on the most likely amounts expected on the related sales transaction and recorded as a reduction to revenue at the time of sale in accordance with the terms of the contract. Accordingly, revenue is recognized net of allowances for estimated returns and incentives.

The Company also offers a lifetime warranty for direct-to-consumer sales of its oxygen concentrators. For a fixed price, the Company agrees to provide a fully functional oxygen concentrator for the remaining life of the patient. Lifetime warranties are only offered to patients upon the initial sale of oxygen concentrators directly from the Company and are non-transferable. Lifetime warranties are considered to be a distinct performance obligation that are accounted for separately from its sale of oxygen concentrators with a standard warranty of three years.

The revenue is allocated to the distinct lifetime warranty performance obligation based on a relative SSP method. The Company has vendor-specific objective evidence of the selling price for its equipment. To determine the selling price of the lifetime warranty, the Company uses its best estimate of the SSP for the distinct performance obligation as the lifetime warranty is neither separately priced nor is the selling price available through third-party evidence. To calculate the selling price associated with the lifetime warranties, management considers the profit margins of service revenue, the average estimated cost of lifetime warranties and the price of extended warranties. Revenue from the distinct lifetime warranty is deferred after the delivery of the equipment and recognized based on an estimated mortality rate over five years, which is the estimated performance period of the contract based on the average patient life expectancy.

Revenue from the sale of the Company's repair services is recognized when the performance obligations are satisfied and collection of the receivables is probable. Other revenue from sale of replacement parts is generally recognized when product is shipped to customers.

(amounts in thousands, except share and per share amounts)

Freight revenue consists of fees associated with the deployment of products internationally and domestically when expedited freight options are requested or when minimum order quantities are not met. Freight revenue is generally recognized upon shipment of the product but is deferred if control has not yet transferred to the customer. Shipping and handling costs for sold products and rental assets shipped to the Company's customers are included on the consolidated statements of comprehensive income as part of cost of sales revenue and cost of rental revenue, respectively.

The payment terms and conditions of customer contracts vary by customer type and the products and services offered. For certain products or services and customer types, the Company requires payment before the products or services are delivered to the customer. The timing of sales revenue recognition, billing and cash collection results in billed accounts receivable and deferred revenue in the consolidated balance sheet.

Contract liabilities primarily consist of deferred revenue related to lifetime warranties on direct-to-consumer sales revenue when cash payments are received in advance of services performed under the contract. The contract with the customer states the final terms of the sale, including the description, quantity, and price of each product or service purchase. The increase in deferred revenue related to lifetime warrantiesfor the six months ended June 30, 2019was primarily driven by $5,018 of payments received in advance of satisfying performance obligations, partially offset by $3,055 of revenues recognized that were included in the deferred revenue balances as of December 31, 2018 Deferred revenue related to lifetime warranties was $16,837 and $14,874 as of June 30, 2019 and December 31, 2018, respectively, and is classified within deferred revenue – current and noncurrent deferred revenue in the consolidated balance sheet.

The Company elected to apply the practical expedient in accordance withAccounting Standards Codification (ASC) 606—*Revenue Recognition* and did not evaluate contracts of one year or less for the existence of a significant financing component. The Company does not expect any revenue to be recognized over a multi-year period with the exception of revenue related to lifetime warranties.

The Company's sales revenue is primarily derived from the sale of its Inogen One systems, Inogen At Home systems, and related accessories to individual consumers, home medical equipment providers, distributors, the Company's private label partner and resellers worldwide. Sales revenue is classified into two areas: business-to-business sales and direct-to-consumer sales. The following table sets forth the Company's sales revenue disaggregated by sales channel and geographic region:

	Three months ended June 30,		Six months ended June 30,	
Revenue by region and category	**2019**	**2018**	**2019**	**2018**
Business-to-business domestic sales	$ 29,653	$ 32,943	$ 55,714	$ 60,959
Business-to-business international sales	22,564	20,759	42,367	37,665
Direct-to-consumer domestic sales	43,646	38,285	82,600	66,947
Total sales revenue	$ 95,863	$ 91,987	$ 180,681	$ 165,571

Rental revenue

The Company recognizes equipment rental revenue over the non-cancelable lease term, which is one month, less estimated adjustments, in accordance with ASC 842 –*Leases*. The Company has separate contracts with each patient that are not subject to a master lease agreement with any third-party payor. The Company evaluates the individual lease contracts at lease inception and the start of each monthly renewal period to determine if it is reasonably certain that the monthly renewal option and the bargain renewal option associated with the potential capped free rental period would be exercised. Historically, the exercise of the monthly renewal and bargain renewal option is not reasonably certain at lease inception and at most subsequent monthly lease renewal periods. If the Company determines that the reasonably certain threshold for an individual patient is met at lease inception or at a monthly lease renewal period, such determination would impact the bargain renewal period for an individual lease. The Company would first consider the lease classification issue (sales-type lease or operating lease) and then appropriately recognize or defer rental revenue over the lease term, which may include a portion of the capped rental period. The Company deferred $0 associated with the capped rental period as of June 30, 2019 and December 31, 2018.

The lease term begins on the date products are shipped to patients and are recorded at amounts estimated to be received under reimbursement arrangements with third-party payors, including Medicare, private payors, and Medicaid. Due to the nature of the industry and the reimbursement environment in which the Company operates, certain estimates are required to record net revenue and accounts receivable at their net realizable values. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available. Specifically, the complexity of many third-party billing arrangements and the uncertainty of reimbursement amounts for certain services from certain payors may result in adjustments to amounts originally recorded. Such adjustments are typically identified and recorded at the point of cash application, claim denial or account review. The Company adjusts revenue for historical trends on revenue adjustments due to timely filings, deaths, hospice, bad debt and other types of analyzable adjustments on a monthly basis to record rental revenue at the expected collectible amounts Accounts receivable are reduced by an allowance for doubtful accounts which provides for those accounts from which payment is not expected to be received although product was delivered, and revenue was earned. The determination that an account is uncollectible, and the ultimate write-off of that account occurs once collection is considered to be highly unlikely, and it is written-off and charged to the allowance at that time. Amounts billed but not earned due to the timing of the billing cycle are deferred and recognized in revenue on a straight-line basis over the monthly billing period. For example, if the first day of the billing period does not fall on the first of the month, then a portion of the monthly billing period will fall in the subsequent month and the related revenue and cost would be deferred based on the service days in the following month.

The lease agreements generally contain lease and non-lease components. Non-lease components primarily include payments for supplies. The Company elected the practical expedient to treat the lease and non-lease components as a single lease component.

Rental revenue is recognized as earned, less estimated adjustments. Revenue not billed at the end of the period is reviewed for the likelihood of collections and accrued. The rental revenue stream is not guaranteed and payment will cease if the patient no longer needs oxygen or returns the equipment. Revenue recognized is at full estimated allowable amounts; transfers to secondary insurances or patient responsibility have no net effect on revenue. Rental revenue is earned for that entire month if the patient is on service on the first day of the 30-day period commencing on the recurring date of service for a particular claim, regardless if there is a change in condition or death after that date.

Included in rental revenue are unbilled amounts for which the revenue recognition criteria had been met as of period-end but were not yet billed to the payor. The estimate of net unbilled rental revenue recognized is based on historical trends and estimates of future collectability. In addition, the Company estimates potential future adjustments and write-offs of these unbilled amounts and includes these estimates in the allowance for adjustments and write-offs of rental revenue which is netted against gross receivables.

Recently issued accounting pronouncements not yet adopted

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-13,*Accounting for Credit Losses (Topic 326).* The new standard requires the use of an “expected loss” model on certain types of financial instruments. The standard also amends the impairment model for available-for-sale debt securities and requires estimated credit losses to be recorded as allowances instead of reductions to amortized cost of the securities. The ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within those years, with early adoption permitted. The Company is currently evaluating the new guidance but does not expect it to have a material impact on the Company’s consolidated financial statement presentation or results.

In January 2017, the FASB issued ASU No. 2017-04,*Simplifying the Test for Goodwill Impairment.* The new guidance eliminates step two of the goodwill impairment test. Under the new guidance, an entity should recognize an impairment charge for the amount by which a reporting unit’s carrying value exceeds its fair value. The ASU is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the effect of the new guidance but does not expect it to have a material impact on the Company’s consolidated financial statement presentation or results.

In August 2018, the FASB issued ASU No. 2018-13,*Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. The new guidance modifies the disclosure requirements on fair value measurements. The ASU is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. While the Company continues to evaluate the effect of adopting this guidance, the Company expects the fair value disclosures related to marketable securities, as disclosed in Note 3 – Fair value of financial instruments, will be subject to the new standard.

Recently adopted accounting pronouncements

In February 2016, the FASB issued ASU No. 2016-02,*Leases (Topic 842)*. The new guidance requires organizations that lease assets—referred to as "lessees"—to recognize on the consolidated balance sheet the assets and liabilities for the rights and obligations created by those leases with lease terms of more than twelve months. The Company adopted the standard using the modified retrospective transition method at the adoption date of January 1, 2019 that does not require restatement of its comparative periods presented, allows it to apply the standard as of the adoption date and record a cumulative adjustment in retained earnings. As permitted under the transition guidance, the Company carried forward the assessment of whether the Company's contracts contain or are leases, classification of the Company's leases and remaining lease terms. The Company elected the practical expedients to not record leases with an initial term of 12 months or less on the consolidated balance sheet and to not separate lease and non-lease components for all of its leases as the non-lease components are not significant to the overall lease costs. The Company recognized approximately $6,400 of operating lease right-of-use assets and operating lease liabilities on the consolidated balance sheets upon adoption on January 1, 2019. The Company also recognizes equipment rental revenue over the non-cancelable lease term, which is one month, less estimated adjustments, in accordance with Topic 842, effective January 1, 2019. The impact on rental revenue as a result of the adoption did not have a material impact on the Company's consolidated financial presentation or results. There was no cumulative adjustments recorded to retained earnings as a result of the adoption.

In August 2017, the FASB issued ASU No. 2017-12,*Derivatives and Hedging*, which changes both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results, in order to better align an entity's risk management activities and financial reporting for hedging relationships. The amendments expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The Company adopted this standard on January 1, 2019 and adoption of this standard did not have a material impact on the Company's consolidated financial statement presentation or results.

In January 2018, the FASB issued ASU No. 2018-02,*Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The new guidance permits entities the option to reclassify tax effects that are stranded in accumulated other comprehensive income as a result of the implementation of the Tax Cuts and Jobs Act to retained earnings. The Company adopted this standard on January 1, 2019 using the beginning of the period of adoption method and adoption of this standard did not have a material impact on the Company's consolidated financial statement presentation or results.

In June 2018, the FASB issued ASU No. 2018-07,*Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. The new guidance modifies the accounting for nonemployee share-based payments. The Company adopted this standard on January 1, 2019 and adoption of this standard did not have a material impact on the Company's consolidated financial statement presentation or results.

In November 2018, the FASB issued ASU No. 2018-19,*Codification Improvements to Topic 326, Financial Instruments-Credit Losses*, which is an amendment to ASU No. 2016-13 that clarifies the scope of the guidance. The amendment clarifies that receivables arising from operating leases are not within the scope of ASU No. 2016-13 and impairment of receivables arising from operating leases should be accounted for in accordance with ASU No. 2016-02. As a result, the bad debt expense account associated with the rental revenue allowance for doubtful account is charged to rental revenue instead of general and administrative expense upon adoption. This change results in decreased rental revenue and decreased operating expense. The Company adopted the standard using the modified retrospective transition method at the adoption date of January 1, 2019 that does not require restatement of its comparative periods presented. The adoption of this reclassification did not have a material impact on the Company's consolidated financial statement presentation or results.

Business segments

The Company operates and reports in only one operating and reportable segment – development, manufacturing, marketing, sales, and rental of respiratory products. Management reports financial information on a consolidated basis to the Company's chief operating decision maker.

3. Fair value of financial instruments

The Company's financial instruments consist of cash and cash equivalents, marketable securities, accounts receivable, accounts payable and accrued expenses. The carrying values of its financial instruments approximate fair value based on their short-term nature.

Fair value accounting

ASC 820 — *Fair Value Measurements and Disclosures* creates a single definition of fair value, establishes a framework for measuring fair value in U.S. GAAP and expands disclosures about fair value measurements. ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement is to estimate the price at which an orderly transaction to sell an asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Assets and liabilities adjusted to fair value in the balance sheet are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Level inputs, as defined by ASC 820, are as follows:

Level input	Input definition
Level 1	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level 2	Inputs, other than quoted prices included in Level 1 that are observable for the asset or liability through corroboration with market data at the measurement date.
Level 3	Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The Company obtained the fair value of its available-for-sale investments, which are not in active markets, from a third-party professional pricing service using quoted market prices for identical or comparable instruments, rather than direct observations of quoted prices in active markets. The Company's professional pricing service gathers observable inputs for all of its fixed income securities from a variety of industry data providers (e.g., large custodial institutions) and other third-party sources. Once the observable inputs are gathered, all data points are considered, and the fair value is determined. The Company validates the quoted market prices provided by its primary pricing service by comparing their assessment of the fair values against the fair values provided by its investment managers. The Company's investment managers use similar techniques to its professional pricing service to derive pricing as described above. As all significant inputs were observable, derived from observable information in the marketplace or supported by observable levels at which transactions are executed in the marketplace, the Company has classified its marketable securities within Level 2 of the fair value hierarchy.

(amounts in thousands, except share and per share amounts)

The following table summarizes fair value measurements by level for the assets measured at fair value on a recurring basis for cash, cash equivalents and marketable securities:

	As of June 30, 2019				
	Adjusted cost	Gross unrealized gains	Fair value	Cash and cash equivalents	Marketable securities
Cash	$ 34,834	$ —	$ 34,834	$ 34,834	$ —
Level 1:					
Money market accounts	171,094	—	171,094	171,094	—
Level 2:					
Corporate bonds	10,028	8	10,036	3,522	6,514
U.S. Treasury securities	40,145	40	40,185	4,497	35,688
Total	$ 256,101	$ 48	$ 256,149	$ 213,947	$ 42,202

	As of December 31, 2018				
	Adjusted cost	Gross unrealized gains (losses)	Fair value	Cash and cash equivalents	Marketable securities
Cash	$ 33,671	$ —	$ 33,671	$ 33,671	$ —
Level 1:					
Money market accounts	158,438	—	158,438	158,438	—
Level 2:					
Corporate bonds	13,629	(16)	13,613	—	13,613
U.S. Treasury securities	34,620	7	34,627	4,525	30,102
Total	$ 240,358	$ (9)	$ 240,349	$ 196,634	$ 43,715

The following table summarizes the estimated fair value of the Company's investments in marketable securities, classified by the contractual maturity date of the securities:

	June 30, 2019
Due within one year	$ 42,202

Derivative instruments and hedging activities

The Company transacts business in foreign currencies and has international sales and expenses denominated in foreign currencies, subjecting the Company to foreign currency risk. The Company has entered into foreign currency forward contracts, generally with maturities of twelve months or less, to reduce the volatility of cash flows primarily related to forecasted revenue denominated in certain foreign currencies. These contracts allow the Company to sell Euros in exchange for U.S. dollars at specified contract rates. Forward contracts are used to hedge forecasted sales over specific months. Changes in the fair value of these forward contracts designed as cash flow hedges are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity and are recognized in the consolidated statements of comprehensive income during the period which approximates the time the corresponding sales occur. The Company may also enter into foreign exchange contracts that are not designated as hedging instruments for financial accounting purposes. These contracts are generally entered into to offset the gains and losses on certain asset and liability balances until the expected time of repayment. Accordingly, any gains or losses resulting from changes in the fair value of the non-designated contracts are reported in other expense, net in the consolidated statements of comprehensive income. The gains and losses on these contracts generally offset the gains and losses associated with the underlying foreign currency-denominated balances, which are also reported in other income (expense), net.

(amounts in thousands, except share and per share amounts)

The Company records the assets or liabilities associated with derivative instruments and hedging activities at fair value based on Level 2 inputs in other current assets or other current liabilities, respectively, in the consolidated balance sheet. The Company had related receivables of $431 and $472 as of June 30, 2019 and December 31, 2018, respectively. The Company classifies the foreign currency derivative instruments within Level 2 in the fair value hierarchy as the valuation inputs are based on quoted prices and market observable data of whether it is designated and qualifies for hedge accounting.

The Company documents the hedging relationship and its risk management objective and strategy for undertaking the hedge, the hedging instrument, the hedged transaction, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method used to measure ineffectiveness. The Company assesses hedge effectiveness and ineffectiveness at a minimum quarterly but may assess it monthly. For derivative instruments that are designed and qualify as part of a cash flow hedging relationship, the effective portion of the gain or loss on the derivative is reported in other comprehensive income (loss) and reclassified into earnings in the same periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current period earnings.

The Company will discontinue hedge accounting prospectively when it determines that the derivative is no longer effective in offsetting cash flows attributable to the hedge risk. The cash flow hedge is de-designated because a forecasted transaction is not probable of occurring, or management determines to remove the designation of the cash flow hedge. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Company continues to carry the derivative at its fair value on the balance sheet and recognizes any subsequent changes in the fair value in earnings. When it is probable that a forecasted transaction will not occur, the Company will discontinue hedge accounting and recognize immediately in earnings gains and losses that were accumulated in other comprehensive income (loss) related to the hedging relationship.

Accumulated other comprehensive income (loss)

The components of accumulated other comprehensive income (loss) were as follows:

	Foreign currency translation adjustments	Unrealized gains on marketable securities	Unrealized gains (losses) on cash flow hedges	Accumulated other comprehensive income (loss)
Balance as of December 31, 2018	$ 394	$ —	$ 330	$ 724
Other comprehensive income (loss)	(31)	36	(76)	(71)
Balance as of June 30, 2019	$ 363	$ 36	$ 254	$ 653

Comprehensive income (loss) is the total net earnings and all other non-owner changes in equity. Except for net income and unrealized gains and losses on cash flow hedges, the Company does not have any transactions or other economic events that qualify as comprehensive income (loss).

4. Balance sheet components

Cash, cash equivalents and marketable securities

The Company considers all short-term highly liquid investments with a maturity of three months or less to be cash equivalents. The Company's marketable debt securities are classified and accounted for as available-for-sale. Cash equivalents are recorded at cost plus accrued interest, which is considered adjusted cost, and approximates fair value. Marketable debt securities are included in cash equivalents and marketable securities based on the maturity date of the security. Short-term investments are included in marketable securities in the current period presentation.

The Company considers investments with maturities greater than three months, but less than one year, to be marketable securities. Investments are reported at fair value with realized and unrealized gains or losses reported in other income (expense), net.

(amounts in thousands, except share and per share amounts)

The Company reviews its investments to identify and evaluate investmentsthat have an indication of possible impairment. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and the Company's intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. Credit losses and other-than-temporary impairments are declines in fair value that are not expected to recover and are charged to other income (expense), net. Cash, cash equivalents, and marketable securities consist of the following:

Cash and cash equivalents	**June 30, 2019**	**December 31, 2018**
Cash	$ 34,834	$ 33,671
Money market accounts	171,094	158,438
Corporate bonds	3,522	—
U.S. Treasury securities	4,497	4,525
Total cash and cash equivalents	$ 213,947	$ 196,634
Marketable securities		
Corporate bonds	$ 6,514	$ 13,613
U.S. Treasury securities	35,688	30,102
Total marketable securities	$ 42,202	$ 43,715

Accounts receivable and allowance for bad debts, returns, and adjustments

Accounts receivable are customer obligations due under normal sales and rental terms. The Company performs credit evaluations of the customers' financial condition and generally does not require collateral. The allowance for doubtful accounts is maintained at a level that, in management's opinion, is adequate to absorb potential losses related to accounts receivable and is based upon the Company's continuous evaluation of the collectability of outstanding balances. Management's evaluation takes into consideration such factors as past bad debt experience, economic conditions and information about specific receivables. The Company's evaluation also considers the age and composition of the outstanding amounts in determining their net realizable value.

The allowance for doubtful accounts is based on estimates, and ultimate losses may vary from current estimates. As adjustments to these estimates become necessary, they are reported in general and administrative expense for sales revenue and as a reduction of rental revenue in the periods in which they become known. The allowance is increased by bad debt provisions, net of recoveries, and is reduced by direct write-offs.

The Company generally does not allow returns from providers for reasons not covered under its standard warranty. Therefore, provision for returns applies primarily to direct-to-consumer sales. This reserve is calculated based on actual historical return rates under the Company's 30-day return program and is applied to the related sales revenue for the last month of the quarter reported.

The Company also records an allowance for rental revenue adjustments which is recorded as a reduction of rental revenue and net rental accounts receivable balances. These adjustments result from contractual adjustments, audit adjustments, untimely claims filings, or billings not paid due to another provider performing same or similar functions for the patient in the same period, all of which prevent billed revenue from becoming realizable. The reserve is based on historical revenue adjustments as a percentage of rental revenue billed and unbilled during the related period.

When recording the allowance for doubtful accounts for sales revenue, the bad debt expense account (general and administrative expense account) is charged; when recording allowance for sales returns, the sales returns account (contra sales revenue account) is charged; and when recording the allowances for rental reserve adjustments and doubtful accounts, the rental revenue adjustments account (contra rental revenue account) is charged. Prior to the adoption of ASC 842, the Company separately recorded an allowance for doubtful accounts by charging bad debt expense, which is now recorded as part of rental revenue adjustments during the three and six months ended June 30, 2019.

(amounts in thousands, except share and per share amounts)

As of June 30, 2019 and December 31, 2018, included in accounts receivable on the consolidated balance sheets were earned but unbilled receivables of $534 and $589, respectively. These balances reflect gross unbilled receivables prior to any allowances for adjustments and write-offs. The Company consistently applies its allowance estimation methodology from period-to-period. The Company's best estimate is made on an accrual basis and adjusted in future periods as required. Any adjustments to the prior period estimates are included in the current period. As additional information becomes known, the Company adjusts its assumptions accordingly to change its estimate of the allowance.

Gross accounts receivable balance concentrations by major category as of June 30, 2019 and December 31, 2018 were as follows:

Gross accounts receivable	**June 30, 2019**	**December 31, 2018**
Rental (1)	$ 3,110	$ 3,406
Business-to-business and other receivables (2)	45,838	35,656
Total gross accounts receivable	$ 48,948	$ 39,062

Net accounts receivable (gross accounts receivable, net of allowances) balance concentrations by major category as of June 30, 2019 and December 31, 2018 were as follows:

Net accounts receivable	**June 30, 2019**	**December 31, 2018**
Rental (1)	$ 2,310	$ 2,413
Business-to-business and other receivables (2)	44,411	34,628
Total net accounts receivable	$ 46,721	$ 37,041

(1) Rental includes Medicare, Medicaid/other government, private insurance and patient pay.

(2) Business-to-business receivables included one customer with a gross accounts receivable balance of $18,989 and $16,198 as of June 30, 2019 and December 31, 2018, respectively. This customer received extended payment terms through a direct financing plan offered. The Company also has a credit insurance policy in place, which allocated up to $20,000 in coverage as of June 30, 2019 and allocated up to $18,000 in coverage as of December 31, 2018 for this customer with a $400 deductible and 10% retention.

The following tables set forth the accounts receivable allowances as of June 30, 2019 and December 31, 2018:

Allowances - accounts receivable	**June 30, 2019**	**December 31, 2018**
Doubtful accounts (1)	$ 450	$ 693
Rental revenue adjustments (1)	473	438
Sales returns	1,304	890
Total allowances - accounts receivable	$ 2,227	$ 2,021

(1) Prior to the adoption of ASC 842, the Company separately recorded an allowance for doubtful accounts by charging bad debt expense. Upon adoption of ASC 842, such balances are recorded as part of rental revenue adjustments to report rental revenue at an expected collectible amount.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash, cash equivalents, marketable securities and accounts receivable. At times, cash account balances may be in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). However, management believes the risk of loss to be minimal. The Company performs periodic evaluations of the relative credit standing of these institutions and has not experienced any losses on its cash and cash equivalents to date. The Company has also entered into hedging relationships with a single counterparty to offset the forecasted Euro-based revenues. The credit risk has been reduced due to a net settlement arrangement whereby the Company is allowed to net settle transactions with a single net amount payable by one party to the other.

(amounts in thousands, except share and per share amounts)

Concentration of customers and vendors

The Company primarily sells its products to traditional home medical equipment providers, distributors, and resellers in the United States and in foreign countries on a credit basis. The Company also sells its products direct-to-consumers on a primarily prepayment basis. No single customer represented more than 10% of the Company's total revenue for the six months ended June 30, 2019, and one single customer represented more than 10% of the Company's total revenue for the six months ended June 30, 2018.Two customers each represented more than 10% of the Company's net accounts receivable balance with accounts receivable balances of $18,989 and $6,159, respectively, as of June 30, 2019, and $16,198 and $4,155, respectively, as of December 31, 2018.

The Company currently purchases raw materials from a limited number of vendors, which resulted in a concentration of three major vendors. The three major vendors supply the Company with raw materials used to manufacture the Company's products. For the six months ended June 30, 2019, the Company's three major vendors accounted for 21.5%, 13.1%, and 9.3%, respectively, of total raw material purchases. For the six months ended June 30, 2018, the Company's three major vendors accounted for 20.2%, 13.8% and 9.3%, respectively, of total raw material purchases.

A portion of revenue is earned from sales outside the United States. Approximately71.8% and 76.0% of the non-U.S. revenue for the three months ended June 30, 2019 and June 30, 2018, respectively, were invoiced in Euros. Approximately 71.6% and 76.4% of the non-U.S. revenue for the six months ended June 30, 2019 and June 30, 2018, respectively, were invoiced in Euros. A breakdown of the Company's revenue from U.S. and non-U.S. sources for the three and six months ended June 30, 2019 and June 30, 2018, respectively, is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2019	**2018**	**2019**	**2018**
U.S. revenue	$ 78,499	$ 76,479	$ 148,898	$ 138,624
Non-U.S. revenue	22,564	20,759	42,367	37,665
Total revenue	$ 101,063	$ 97,238	$ 191,265	$ 176,289

Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using a standard cost method, including material, labor and manufacturing overhead, whereby the standard costs are updated at least quarterly to reflect approximate actual costs using the first-in, first-out (FIFO) method. The Company records adjustments at least quarterly to inventory for potentially excess, obsolete, slow-moving or impaired items. The Company recorded noncurrent inventory related to inventories that are expected to be realized or consumed after one year of $1,119 and $1,085 as of June 30, 2019 and December 31, 2018, respectively. Noncurrent inventories are primarily related to raw materials purchased in bulk to support long-term expected repairs to reduce costs and are classified in other assets. Inventories that are considered current consist of the following:

	June 30, 2019	**December 31, 2018**
Raw materials and work-in-progress	$ 22,082	$ 24,980
Finished goods	3,017	2,756
Less: reserves	(614)	(665)
Inventories, net	$ 24,485	$ 27,071

Property and equipment

Property and equipment are stated at cost. Depreciation and amortization are calculated using the straight-line method over the assets' estimated useful lives as follows:

Rental equipment	1.5-5 years
Manufacturing equipment and tooling	3-5 years
Computer equipment and software	2-3 years
Furniture and equipment	3-5 years
Leasehold improvements	Lesser of estimated useful life or remaining lease term

(amounts in thousands, except share and per share amounts)

Expenditures for additions, improvements and replacements are capitalized and depreciated to a salvage value of $0. Repair and maintenance costs on rental equipment are included in cost of rental revenue on the consolidated statements of comprehensive income. Repair and maintenance expense, which includes labor, parts and freight, for rental equipment was $701 and $630 for the three months ended June 30, 2019 and June 30, 2018, respectively, and $1,363 and $1,190 for the six months ended June 30, 2019 and June 30, 2018, respectively.

Included within property and equipment is construction in process, primarily related to the design and engineering of tooling, jigs and other machinery. In addition, this item also includes computer software or development costs that have been purchased but have not completed the final configuration process for implementation into the Company's systems. These items have not been placed in service; therefore, no depreciation or amortization was recognized for these items in the respective periods.

Depreciation and amortization expense related to rental equipment and other property and equipment are summarized below for the three and six months ended June 30, 2019 and June 30, 2018, respectively.

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Rental equipment	$ 1,594	$ 1,966	$ 3,299	$ 4,131
Other property and equipment	842	551	1,603	1,081
Total depreciation and amortization	$ 2,436	$ 2,517	$ 4,902	$ 5,212

Property and equipment and rental equipment with associated accumulated depreciation is summarized below as of June 30, 2019 and December 31, 2018, respectively.

Property and equipment	June 30, 2019	December 31, 2018
Rental equipment, net of allowances of $474 and $594, respectively	$ 40,587	$ 43,038
Other property and equipment	23,776	21,596
Property and equipment	64,363	64,634
Accumulated depreciation		
Rental equipment	30,945	31,813
Other property and equipment	12,057	10,480
Accumulated depreciation	43,002	42,293
Property and equipment, net		
Rental equipment, net of allowances of $474 and $594, respectively	9,642	11,225
Other property and equipment	11,719	11,116
Property and equipment, net	$ 21,361	$ 22,341

Long-lived assets

The Company accounts for the impairment and disposition of long-lived assets in accordance with ASC 360— *Property, Plant, and Equipment.* In accordance with ASC 360, long-lived assets to be held are reviewed for events or changes in circumstances that indicate that their carrying value may not be recoverable. The Company periodically reviews the carrying value of long-lived assets to determine whether or not impairment to such value has occurred. No impairments were recorded as of June 30, 2019 and June 30, 2018.

(amounts in thousands, except share and per share amounts)

Goodwill

The changes in the carrying amount of goodwill for the six months ended June 30, 2019 were as follows:

Balance as of December 31, 2018	$ 2,257
Translation adjustment	(15)
Balance as of June 30, 2019	$ 2,242

Intangible assets

There were no impairments recorded related to the Company's intangible assets as of June 30, 2019 and June 30, 2018. Amortization expense for intangible assets for the three months ended June 30, 2019 and June 30, 2018 was $324 and $299, respectively, and for the six months ended June 30, 2019 and June 30, 2018 was $652 and $597, respectively.

The following tables represent the changes in net carrying values of intangible assets as of the respective dates:

June 30, 2019	**Average estimated useful lives (in years)**	**Gross carrying amount**	**Accumulated amortization**	**Net amount**
Licenses	10	$ 185	$ 160	$ 25
Patents and websites	5	4,164	1,974	2,190
Customer relationships	4	1,364	739	625
Non-compete agreement	2.3	228	217	11
Commercials	2-3	664	388	276
Total		$ 6,605	$ 3,478	$ 3,127

December 31, 2018	**Average estimated useful lives (in years)**	**Gross carrying amount**	**Accumulated amortization**	**Net amount**
Licenses	10	$ 185	$ 155	$ 30
Patents and websites	5	4,164	1,640	2,524
Customer relationships	4	1,373	572	801
Non-compete agreement	2.3	229	154	75
Commercials	2-3	633	308	325
Total		$ 6,584	$ 2,829	$ 3,755

Annual estimated amortization expense for each of the succeeding fiscal years is as follows:

	June 30, 2019
Remaining 6 months of 2019	$ 586
2020	1,145
2021	852
2022	544
2023	—
Thereafter	—
	$ 3,127

(amounts in thousands, except share and per share amounts)

Current liabilities

Accounts payable and accrued expenses as of June 30, 2019 and December 31, 2018 consisted of the following:

	June 30, 2019	December 31, 2018
Accounts payable	$ 16,071	$ 13,720
Accrued inventory (in-transit and unvouchered receipts) and trade payables	8,225	9,597
Accrued purchasing card liability	1,407	2,089
Accrued franchise, sales and use taxes	621	518
Other accrued expenses	1,001	862
Accounts payable and accrued expenses	$ 27,325	$ 26,786

Accrued payroll as of June 30, 2019 and December 31, 2018 consisted of the following:

	June 30, 2019	December 31, 2018
Accrued bonuses	$ 669	$ 4,780
Accrued wages and other payroll related items	3,105	3,494
Accrued vacation	2,107	1,959
Accrued employee stock purchase plan deductions	1,088	1,174
Accrued payroll	$ 6,969	$ 11,407

5. Leases

The Company has entered into operating leases primarily for commercial buildings. These leases have terms which range from 2 years to 8 years, some of which include options to extend the leases for up to 5 years. There are no economic penalties for the Company to extend the lease, and it is not reasonably assured that the Company will exercise the extension options. Based on the present value of the lease payments for the remaining lease term of the Company's existing leases, the Company recognized operating lease right-of-use assets and operating lease liabilities of $6,418 on January 1, 2019. Operating lease right-of-use assets and liabilities commencing after January 1, 2019 are recognized at commencement date based on the present value of lease payments over the lease term. The operating leases do not contain material residual value guarantees or material restrictive covenants.

As a result of the MedSupport acquisition, the Company leases a property owned by a related party. Operating lease cost for the property was $8 and $16 for the three and six months ended June 30, 2019, respectively, which is included in the total operating lease cost.

Information related to the Company's right-of-use assets and related operating lease liabilities were as follows:

	Six months ended June 30, 2019
Cash paid for operating lease liabilities	$ 1,164
Operating lease cost	1,087
Non-cash right-of-use assets obtained in exchange for new operating lease obligations	6,418
Weighted-average remaining lease term	2.8 years
Weighted-average discount rate	3.8 %

(amounts in thousands, except share and per share amounts)

Maturities of lease liabilities due in the 12-month period ending June 30,		
2020	$	2,213
2021		1,561
2022		1,167
2023		921
2024		902
Thereafter		226
		6,990
Less imputed interest		(528)
Total lease liabilities	$	6,462
Current operating lease liabilities	$	2,006
Operating lease liabilities - noncurrent	$	4,456
Total lease liabilities	$	6,462

As of June 30, 2019, the Company has an additional operating lease for its corporate headquarters that has not yet commenced, with total minimum lease payments of $1,549. Lease payments will increase annually by the lesser of the change, if any, in the Consumer Price Index of the Bureau of Labor Statistics of the U.S. Department of Labor or three and one-half percent (3.5%) at each annual adjustment date thereafter. This operating lease will commence in 2020 with a lease term of10 years. This table does not include lease payments that were not fixed at commencement or modification.

6. Earnings per share

Earnings per share (EPS) is computed in accordance with ASC 260—*Earnings per Share* and is calculated using the weighted-average number of common shares outstanding during each period. Diluted EPS assumes the conversion, exercise or issuance of all potential common stock equivalents (which can include dilution of outstanding stock options, restricted stock units and restricted stock awards) unless the effect is to reduce a loss or increase the income per share. For purposes of this calculation, common stock subject to repurchase by the Company, options, and other dilutive awards are considered to be common stock equivalents and are only included in the calculation of diluted earnings per share when their effect is dilutive.

Basic earnings per share is calculated using the Company's weighted-average outstanding common shares. Diluted earnings per share is calculated using the Company's weighted-average outstanding common shares including the dilutive effect of stock awards as determined under the treasury stock method.

(amounts in thousands, except share and per share amounts)

The computation of EPS is as follows:

	Three months ended June 30,		Six months ended June 30,	
	2019	**2018**	**2019**	**2018**
Numerator—basic and diluted:				
Net income	$ 10,160	$ 14,610	$ 15,462	$ 25,368
Denominator:				
Weighted-average common shares - basic common stock (1)	21,815,634	21,172,170	21,783,150	21,099,566
Weighted-average common shares - diluted common stock	22,359,679	22,503,749	22,459,101	22,409,011
Net income per share - basic common stock	$ 0.47	$ 0.69	$ 0.71	$ 1.20
Net income per share - diluted common stock	$ 0.45	$ 0.65	$ 0.69	$ 1.13
Denominator calculation from basic to diluted:				
Weighted-average common shares - basic common stock (1)	21,815,634	21,172,170	21,783,150	21,099,566
Stock options and other dilutive awards	544,045	1,331,579	675,951	1,309,445
Weighted-average common shares - diluted common stock	22,359,679	22,503,749	22,459,101	22,409,011
Shares excluded from diluted weighted-average shares:				
Stock options	66,485	—	—	—
Restricted stock units and restricted stock awards	158,680	25,194	165,060	83,517
Shares excluded from diluted weighted-average shares	225,165	25,194	165,060	83,517

(1) Unvested restricted stock units and restricted stock awards are not included as shares outstanding in the calculation of basic earnings per share. Vested restricted stock units and restricted stock awards are included in basic earnings per share if all vesting and performance criteria have been met. Performance-based restricted stock units and restricted stock awards are included in the number of shares used to calculate diluted earnings per share as long as all applicable performance criteria are met, and their effect is dilutive. Restricted stock awards are eligible to receive all dividends declared on the Company's common shares during the vesting period; however, such dividends are not paid until the restrictions lapse.

The computations of diluted net income attributable to common stockholders exclude common stock options, restricted stock units, and restricted stock awards, which were anti-dilutive for the three and six months ended June 30, 2019 and June 30, 2018.

7. Income taxes

The Company accounts for income taxes in accordance with ASC 740—*Income Taxes*. Under ASC 740, income taxes are recognized for the amount of taxes payable or refundable for the current period and deferred tax liabilities and assets are recognized for the future tax consequences of transactions that have been recognized in the Company's consolidated financial statements or tax returns. A valuation allowance is provided when it is more likely than not that some portion, or all, of the deferred tax asset will not be realized.

The Company accounts for uncertainties in income tax in accordance with ASC 740-10—*Accounting for Uncertainty in Income Taxes*. ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This accounting standard also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company recognizes interest and penalties on taxes, if any, within its income tax provision on its consolidated statements of comprehensive income.No significant interest or penalties were recognized during the periods presented.

The Company operates in several taxing jurisdictions, including U.S. federal, multiple U.S. states and the Netherlands. The statute of limitations has expired for all tax years prior to 2015 for federal and 2014 to 2015 for various state tax purposes. However, the net operating loss generated on the Company's federal and state tax returns in prior years may be subject to adjustments by the federal and state tax authorities.

The Company determined the income tax provision for interim periods using an estimate of the Company's annual effective tax rate, adjusted for discrete items arising in that quarter. In each quarter, the Company updates its estimated annual effective tax rate, and if the estimated annual effective tax rate changes, a cumulative adjustment is recorded in that quarter. The Company's quarterly income tax provision and quarterly estimate of the annual effective tax rate are subject to volatility due to several factors, including our ability to accurately predict the proportion of our income (loss) before provision for income taxes in multiple jurisdictions, the tax effects of our stock-based compensation, and the effects of its foreign entity.

8. Stockholders' equity

The Company has a 2002 Stock Incentive Plan (2002 Plan) as amended, under which the Company granted options to purchase shares of its common stock. As of June 30, 2019, options to purchase 2,018 shares of common stock remained outstanding under the 2002 Plan. The 2002 Plan was terminated in March 2012 in connection with the adoption of the 2012 Plan, and, accordingly, no new options are available for issuance under this plan. The 2002 Plan continues to govern outstanding awards granted thereunder.

The Company has a 2012 Equity Incentive Plan (2012 Plan) under which the Company granted options to purchase shares of its common stock. As of June 30, 2019, options to purchase 142,786 shares of common stock remained outstanding under the 2012 Plan. The 2012 Plan was terminated in connection with the Company's initial public offering in February 2014, and accordingly, no new options are available for issuance under this plan. The 2012 Plan continues to govern outstanding awards granted thereunder.

The Company has a 2014 Equity Incentive Plan (2014 Plan) that provides for the grant of incentive stock options, within the meaning of Section 422 of the Internal Revenue Code, to the Company's employees and any parent and subsidiary corporation's employees, and for the grant of nonstatutory stock options, restricted stock, restricted stock units, restricted stock awards, stock appreciation rights, performance units and performance shares to its employees, directors and consultants and its parent and subsidiary corporations' employees and consultants.

As of June 30, 2019, awards with respect to1,049,917 shares of the Company's common stock were outstanding, and1,863,260 shares of common stock remained available for issuance under the 2014 Plan. The shares available for issuance under the 2014 Plan will be increased by any shares returned to the 2002 Plan, 2012 Plan and the 2014 Plan as a result of expiration or termination of awards (provided that the maximum number of shares that may be added to the 2014 Plan pursuant to such previously granted awards under the 2002 Plan and 2012 Plan is 2,328,569 shares). The number of shares available for issuance under the 2014 Plan also is increased annually on the first day of each fiscal year by an amount equal to the least of:

- 895,346 shares;
- 4% of the outstanding shares of common stock as of the last day of the Company's immediately preceding fiscal year; or
- such other amount as the Company's board of directors may determine

.

For 2019, no additional shares were added to the 2014 Plan share reserve pursuant to the provision described above.

Stock options

Options typically expire between seven andten years from the date of grant and vest over one to four year terms. Options have been granted to employees, directors and consultants of the Company, as determined by the board of directors, at the deemed fair market value of the shares underlying the options at the date of grant.

(amounts in thousands, except share and per share amounts)

The activity for stock options under the Company's stock plans is as follows:

	Options	Price per share	Weighted-average exercise price	Remaining weighted-average contractual terms (in years)	Per share average intrinsic value
Outstanding as of December 31, 2018	1,127,336	$0.75-$83.30	$ 34.89	3.84	$ 89.28
Granted	—	—	—		
Exercised	(75,315)	0.75-58.95	24.96		
Forfeited	(35,316)	38.54-58.95	44.45		
Expired	—	—	—		
Outstanding as of June 30, 2019	1,016,705	0.75-83.30	35.30	3.34	32.51
Vested and exercisable as of June 30, 2019	902,341	0.75-83.30	34.12	3.27	33.82
Vested and expected to vest as of June 30, 2019	1,009,324	$0.75-$83.30	$ 35.23	3.34	$ 32.59

The total intrinsic value of options exercised during the six months ended June 30, 2019 and June 30, 2018 was $6,870 and $32,956, respectively. The unrecognized compensation expense related to non-vested stock-based compensation granted under the Plans as of June 30, 2019 was $1,687.

Stock incentive awards

The Company grants restricted stock units (RSUs) and restricted stock awards (RSAs) under the 2014 Plan (Stock Awards). The Stock Awards vest either based solely on the satisfaction of time-based service conditions or on the satisfaction of time-based service conditions combined with performance criteria. Stock Awards are subject to forfeiture if the holder's services to the Company terminate before vesting.

Stock Awards granted with only time-based service vesting conditions generally vest over a four-year service period, as defined in the terms of each award. Stock Awards that vest based on the satisfaction of time-based service conditions combined with performance criteria generally vest over a three-year service and performance period, based on performance criteria established at the time of the award. The portion of the Stock Award that is earned may equal or be less than the targeted number of shares subject to the Stock Award depending on whether the performance criteria are met.

(amounts in thousands, except share and per share amounts)

Stock Awards activity for the six months ended June 30, 2019 are summarized below:

Restricted stock units	Time-based	Performance and time-based	Total	Weighted-average grant date fair value per share
Unvested restricted stock units outstanding as of December 31, 2018	58,589	8,739	67,328	$ 115.16
Granted	49,892	—	49,892	96.52
Vested	(17,690)	(4,366)	(22,056)	125.95
Forfeited/canceled	(6,632)	(1,239)	(7,871)	89.42
Unvested restricted stock units outstanding as of June 30, 2019 (1)	84,159	3,134	87,293	$ 104.10
Unvested and expected to vest restricted stock units outstanding as of June 30, 2019			82,866	$ 103.77

Restricted stock awards	Time-based	Performance and time-based	Total	Weighted-average grant date fair value per share
Unvested restricted stock awards outstanding as of December 31, 2018	36,937	47,821	84,758	$ 115.80
Granted	26,778	40,166	66,944	106.97
Vested	(8,699)	(15,732)	(24,431)	114.89
Forfeited/canceled	(7,093)	(9,627)	(16,720)	109.11
Unvested restricted stock awards outstanding as of June 30, 2019 (1)	47,923	62,628	110,551	$ 112.23
Unvested and expected to vest restricted stock awards outstanding as of June 30, 2019			66,529	$ 112.65

(1) Outstanding restricted stock units and restricted stock awards are based on the maximum payout of the targeted number of shares.

As of June 30, 2019, the unrecognized compensation cost related to unvested employee restricted stock units and restricted stock awards was $4,087, excluding estimated forfeitures. This amount is expected to be recognized over a weighted-average period of 2.8 years.

Employee stock purchase plan

The Company's 2014 Employee Stock Purchase Plan (ESPP) provides for the grant to all eligible employees an option to purchase stock under the ESPP, within the meaning Section 423 of the Internal Revenue Code. The ESPP permits participants to purchase common stock through payroll deductions of up to 15% of their eligible compensation, which includes a participant's base straight time gross earnings, incentive compensation, bonuses, overtime and shift premium, but exclusive of payments for equity compensation and other similar compensation. A participant may purchase a maximum of 1,500 shares during a purchase period. Amounts deducted and accumulated by the participant are used to purchase shares of the Company's common stock at the end of each six-month period. The purchase price of the shares will be 85% of the lower of the fair market value of the Company's common stock on the first trading day of each offering period or on the exercise date. The offering periods are currently approximately six months in length beginning on the first business day on or after March 1 and September 1 of each year and ending on the first business day on or after September 1 and March 1 approximately six months later.

(amounts in thousands, except share and per share amounts)

As of June 30, 2019, a total of 729,681 shares of common stock were available for sale pursuant to the ESPP.

The number of shares available for sale under the ESPP is increased annually on the first day of each fiscal year by an amount equal to the least of:

- 179,069 shares;
- 1.5% of the outstanding shares of the Company's common stock on the last day of the Company's immediately preceding fiscal year; or
- such other amount as may be determined by the administrator.

For 2019, no additional shares were added to the ESPP share reserve pursuant to the provision described above.

Stock-based compensation

Stock-based compensation expense recognized for the three and six months ended June 30, 2019 and June 30, 2018, respectively, was as follows:

	Three months ended June 30,		Six months ended June 30,	
	2019	**2018**	**2019**	**2018**
Stock-based compensation expense by type of award:				
Stock option plan awards	$ 776	$ 1,548	$ 1,923	$ 3,500
Restricted stock units and restricted stock awards	791	1,416	3,048	2,654
Employee stock purchase plan	212	222	394	413
Total stock-based compensation expense	$ 1,779	$ 3,186	$ 5,365	$ 6,567

Employee stock-based compensation expense was calculated based on awards of stock options, restricted stock units and restricted stock awards ultimately expected to vest based on the Company's historical award cancellations. The employee stock-based compensation expense recognized for the six months ended June 30, 2019 and June 30, 2018 has been reduced for estimated forfeitures of stock option plan awards at a rate of 7.3% and 7.3%, respectively. ASC 718 – *Compensation-Stock Compensation* requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

For the three and six months ended June 30, 2019 and June 30, 2018, respectively, stock-based compensation expense recognized under ASC 718, included in cost of revenue, research and development expense, sales and marketing expense, and general and administrative expense was as follows:

	Three months ended June 30,		Six months ended June 30,	
	2019	**2018**	**2019**	**2018**
Cost of revenue	$ 199	$ 259	$ 484	$ 532
Research and development	227	330	604	661
Sales and marketing	336	583	1,026	1,131
General and administrative	1,017	2,014	3,251	4,243
Total stock-based compensation expense	$ 1,779	$ 3,186	$ 5,365	$ 6,567

401(k) retirement savings plan

The Company maintains a 401(k) retirement savings plan for the benefit of eligible employees. Under the terms of this plan, eligible employees are able to make contributions to the plan on a tax-deferred basis. The Company began matching employees' contributions, effective January 1, 2017. The Company contributed $505, net of forfeitures, to the 401(k) plan for the six months ended June 30, 2019 and $417, net of forfeitures, for the six months ended June 30, 2018.

(amounts in thousands, except share and per share amounts)

9. Commitments and contingencies

Non-cancelable contractual obligations

The Company enters into non-cancelable contractual obligations for software licenses and maintenance agreements. As of June 30, 2019, the minimum aggregate payments due under specified non-cancelable contractual obligations are summarized as follows:

	Non-cancelable contractual obligations
Remaining 6 months of 2019	$ 288
2020	578
2021	457
2022	—
2023	—
Thereafter	—
	$ 1,323

Purchase obligations

The Company had approximately $61,700 of outstanding purchase orders with its outside vendors and suppliers as of June 30, 2019.

Warranty obligations

The following table identifies the changes in the Company's aggregate product warranty liabilities for the six and twelve-month periods ended June 30, 2019 and December 31, 2018, respectively:

	June 30, 2019	December 31, 2018
Product warranty liability at beginning of period	$ 9,530	$ 6,171
Accruals for warranties issued	3,948	7,693
Adjustments related to preexisting warranties (including changes in estimates)	(275)	90
Settlements made (in cash or in kind)	(2,878)	(4,424)
Product warranty liability at end of period	$ 10,325	$ 9,530

Legislation and HIPAA

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in exclusion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

The Company believes that it is in compliance in all material respects with applicable fraud and abuse regulations and other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. The Health Insurance Portability and Accountability Act of 1996 (HIPAA) ensures health insurance portability, reduces healthcare fraud and abuse, guarantees security and privacy of health information, and enforces standards for health information. The Health Information Technology for Economic and Clinical Health Act (HITECH Act) imposes notification requirements of certain security breaches relating to protected health information. The Company believes that it complies in all material respects with the provisions of those regulations that are applicable to the Company's business.

Legal proceedings

Securities class action and derivative lawsuits

On March 6, 2019, plaintiff William Fabbri filed a lawsuit against Inogen, Scott Wilkinson, and Alison Bauerlein, in the United States District Court for the Central District of California on behalf of a purported class of purchasers of the Company's securities. On March 21, 2019, plaintiff Steven Friedland filed a substantially similar lawsuit against the same defendants in the same court. On May 20, 2019, the court issued an order consolidating the two lawsuits under the name *In re Inogen, Inc. Sec. Litig.,* No. 2:19-cv-01643-FMO-AGR, appointing Dr. John Vasil and Paragon Fund Management as lead plaintiffs, and appointing Robbins Geller Rudman & Dowd LLP and Glancy Prongay & Murray LLP as lead plaintiffs' counsel. On July 10, 2019, the lead plaintiffs filed a consolidated amended complaint on behalf of a purported class of purchasers of the Company's common stock between November 8, 2017 and May 7, 2019. The complaint generally alleges that the defendants failed to disclose that: (i) Inogen had overstated the true size of the total addressable market for its portable oxygen concentrators and had misstated the basis for its calculation of the total addressable market; (ii) Inogen had falsely attributed its sales growth to the strong sales acumen of its salesforce, rather than to deceptive sales practices; (iii) the growth in Inogen's domestic business-to-business sales to home medical equipment providers was inflated, unsustainable and was eroding direct-to-consumer sales; and (iv) Inogen's decision to focus on sales over rentals of portable oxygen concentrators harmed its ability to serve the Medicare market. The complaint seeks compensatory damages in an unspecified amount, costs and expenses, including attorneys' fees and expert fees, prejudgment and post-judgment interest and such other relief as the court deems proper. The Company intends to vigorously defend itself against these allegations.

On June 26, 2019, plaintiff Twana Brown filed a shareholder derivative lawsuit against Inogen, Scott Wilkinson, Alison Bauerlein, Benjamin Anderson-Ray, Scott Beardsley, R. Scott Greer, Raymond Huggenberger, Heath Lukatch, Loren McFarland, and Heather Rider for breaches of their fiduciary duties as directors and/or officers of Inogen, unjust enrichment, waste of corporate assets and violations of section 14(a) of the Securities Exchange Act of 1934, as amended. The complaint generally alleges similar claims to the securities class action. The complaint seeks compensatory damages in an unspecified amount, changes to the Company's corporate governance and internal procedures, costs and expenses, including attorneys' fees and expert fees, and such other relief as the court deems proper. On August 5, 2019, the court issued an order staying the derivative action pending the resolution of the motion to dismiss stage in *In re Inogen, Inc. Sec. Litig.* The Company intends to vigorously defend itself against these allegations.

Other litigation

In addition to the lawsuits discussed above, the Company is party to various legal proceedings arising in the normal course of business. The Company carries insurance, subject to specified deductibles under the policies, to protect against losses from certain types of legal claims. At this time, the Company does not anticipate that any of these other proceedings arising in the normal course of business will have a material adverse effect on the Company's business. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources, and other factors.

10. Foreign currency exchange contracts and hedging

As of June 30, 2019 and June 30, 2018, the Company's total non-designated and designated derivative contracts had notional amounts totaling approximately $2,388 and $8,926, respectively, and $3,072 and $12,477, respectively. These contracts were comprised of offsetting contracts with the same counterparty, each expires withinone to six months. During the six months ended June 30, 2019 and June 30, 2018, these contracts had, net of tax, an unrealized loss of $76 and an unrealized gain of $543, respectively.

The nonperformance risk of the Company and the counterparty did not have a material impact on the fair value of the derivatives. During the six months ended June 30, 2019 and June 30, 2018, there were no ineffective portions relating to these hedges and the hedges remained effective through their respective settlement dates. As of June 30, 2019, the Company had thirteen designated hedges and three non-designated hedges. As of June 30, 2018, the Company hadtwenty-one designated hedges and four non-designated hedges.

11. Subsequent events

On August 6, 2019, the Company entered into a definitive agreement to acquire New Aera, Inc. (New Aera) for approximately $70,400 in cash at closing and up to $31,400 in potential earn-out payments based on future sales performance and certain regulatory clearances. Upon closing of the acquisition, the Company will also separately acquire certain intellectual property assets from an affiliate of New Aera. New Aera is an innovative developer and manufacturer of portable non-invasive ventilators for people suffering from various chronic lung diseases.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

The following discussion and analysis should be read together with our consolidated financial statements and the condensed notes to those statements included elsewhere in this Quarterly Report on Form 10-Q. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, that are based on our management's beliefs and assumptions and on information currently available to our management. The forward-looking statements are contained principally in the section entitled "Risk Factors" and this Management's Discussion and Analysis of Financial Condition and Results of Operations. Forward-looking statements include, but are not limited to, statements concerning the following:

- information concerning our possible or assumed future cash flow, revenue, sources of revenue and results of operations, operating and other expenses;
- our assessment and expectations regarding reimbursement rates, future rounds of competitive bidding, and future changes in rental revenue;
- our expectations regarding regulatory approvals and government and third-party payor coverage and reimbursement;
- our ability to develop new products, improve our existing products and increase the value of our products, including the integration of New Aera's technology into ours;
- our expectations regarding Inogen Capital;
- our expectations regarding the timing of new products and product improvement launches, as well as product features and specifications;
- market share expectations, unit sales, business strategies, financing plans, expansion of our business, competitive position, industry environment, and potential growth opportunities;
- our expectations regarding the market size, market growth and the growth potential for our business;
- our ability to grow our business, including our ability to develop new products and enter new markets;
- our expectations regarding the average selling price and manufacturing costs of our products, including our expectations to continue to reduce average unit costs for our systems;
- our expectation to expand our sales and marketing channels, including through efforts to focus on improving the productivity of our sales team, changing our rental intake criteria, creating a separate rental sales team, and expanding our advertising campaigns;
- our expectations with respect to our European and U.S. facilities and our expectations with respect to our contract manufacturer in Europe;
- our expectations regarding tariffs being imposed by the United States on certain imported materials and products;
- our ability to successfully acquire and integrate companies and assets, including our recently announced planned acquisition of New Aera;
- our expectations regarding the impact and implementation of trade regulations on our supply chain;
- our expectations regarding excess tax benefits or deficiencies from stock-based compensation;
- our expectations of future accounting pronouncements or changes in our accounting policies;
- our assessments and estimates of our effective tax rate;
- our internal control environment;
- the effects of seasonal trends on our results of operations and estimated hiring plans;
- our expectations regarding the manufacturing ramp-up, domestic and international launch expectations, and market acceptance of our Inogen One G5 portable oxygen concentrator;
- our expectation that our existing capital resources and the cash to be generated from expected product sales and rentals will be sufficient to meet our projected operating and investing requirements for at least the next twelve months; and
- the effects of competition.

Forward-looking statements include statements that are not historical facts and can be identified by terms such as “anticipates,” “believes,” “could,” “seeks,” “estimates,” “expects,” “intends,” “may,” “plans,” “potential,” “predicts,” “projects,” “should,” “will,” “would,” or similar expressions and the negatives of those terms.

Forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from any future results, performance, or achievements expressed or implied by the forward-looking statements. We discuss these risks in greater detail in Part II, Item 1A, “Risk Factors,” elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for us to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the future events and trends discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

The forward-looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. Except as required by law, we assume no obligation to update these forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

This Quarterly Report on Form 10-Q also contains estimates, projections and other information concerning our industry, our business, and the markets for certain diseases, including data regarding the estimated size of those markets, and the incidence and prevalence of certain medical conditions. Information that is based on estimates, forecasts, projections, market research or similar methodologies is inherently subject to uncertainties and actual events or circumstances may differ materially from events and circumstances reflected in this information. Unless otherwise expressly stated, we obtained this industry, business, market and other data from reports, research surveys, studies and similar data prepared by market research firms and other third parties, industry, medical and general publications, government data and similar sources.

“Inogen,” “Inogen One,” “Inogen One G2,” “Inogen One G3,” “G4,” “G5,” “Oxygenation,” “Live Life in Moments, not Minutes,” “Never Run Out of Oxygen,” “Oxygen Therapy on Your Terms,” “Oxygen.Anytime.Anywhere,” “Reclaim Your Independence,” “Intelligent Delivery Technology,” “Inogen At Home,” and the Inogen design are registered trademarks with the United States Patent and Trademark Office of Inogen, Inc. We own trademark registrations for the mark “Inogen” in Australia, Canada, South Korea, Mexico, Europe (European Union Registration), Japan, New Zealand, Turkey, and Singapore. We own pending applications for the mark “Inogen” in Argentina, Brazil, China, Columbia, Ecuador, Iceland, India, Israel, Norway, and Switzerland. We own a trademark registration for the mark “□□□□□” in Japan. We own trademark applications for the marks “□□□” and “□□□” in China. We own trademark registrations for the mark “Inogen One” in Australia, Canada, China, South Korea, Mexico, and Europe (European Union Registration). We own a trademark registration for the mark “Satellite Conserver” in Canada. We own a trademark registration for the mark “Inogen At Home” in Europe (European Union Registration). We own trademark registrations for the mark “G4” in Europe (European Union Registration) and the United Kingdom. We own trademark applications for the Inogen design in Bolivia and China. Other service marks, trademarks, and trade names referred to in this Quarterly Report on Form 10-Q are the property of their respective owners.

In this Quarterly Report on Form 10-Q, “we,” “us” and “our” refer to Inogen, Inc. and its subsidiaries.

The following discussion of our financial condition and results of operations should be read together with our consolidated financial statements and the accompanying condensed notes to those statements included elsewhere in this document. Also, forward-looking statements represent our management’s beliefs and assumptions only as of the date of this Quarterly Report on Form 10-Q.

Critical accounting policies and significant estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements which have been prepared in accordance with generally accepted accounting principles in the United States of America, or U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and related disclosure of contingent assets and liabilities, revenue and expenses at the date of the financial statements. Generally, we base our estimates on historical experience and on various other assumptions in accordance with U.S. GAAP that we believe to be reasonable under the circumstances. Actual results may differ from these estimates and such differences could be material to the financial position and results of operations.

There have been no material changes in our critical accounting policies and estimates in the preparation of our consolidated financial statements during the three and six months ended June 30, 2019 compared to those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2018, as filed with the SEC on February 26, 2019.

Overview

We are a medical technology company that primarily develops, manufactures and markets innovative portable oxygen concentrators used to deliver supplemental long-term oxygen therapy to patients suffering from chronic respiratory conditions. Long-term oxygen therapy is defined as the provision of oxygen therapy for use at home in patients who have chronic low blood oxygen levels (hypoxemia). Traditionally, these patients have relied on stationary oxygen concentrator systems for use in the home and oxygen tanks or cylinders for mobile use, which we call the delivery model. The tanks and cylinders must be delivered regularly and have a finite amount of oxygen, which requires patients to plan activities outside of their homes around delivery schedules and a finite oxygen supply. Additionally, patients must attach long, cumbersome tubing to their stationary concentrators simply to enable mobility within their homes. Our proprietary Inogen One® systems concentrate the air around the patient to offer a single source of supplemental oxygen anytime, anywhere with a portable device weighing as little as approximately 2.8 pounds with a single battery. We believe our Inogen One systems reduce the patient's reliance on stationary concentrators and scheduled deliveries of tanks with a finite supply of oxygen, thereby improving patient quality of life and fostering mobility.

In May 2004, we received 510(k) clearance from the U.S. Food and Drug Administration, or the FDA, for our Inogen One portable oxygen concentrator. From our launch of the Inogen One in 2004, through 2008, we derived our revenue almost exclusively from sales to healthcare providers and distributors. In December 2008, we acquired Comfort Life Medical Supply, LLC in order to secure access to the Medicare rental market and began accepting Medicare reimbursement for our oxygen solutions in certain states. At the time of the acquisition, Comfort Life Medical Supply, LLC had an active Medicare billing number but few other assets and limited business activities. In January 2009, following the acquisition of Comfort Life Medical Supply, LLC, we initiated our direct-to-consumer rental strategy and began renting Inogen One systems directly to patients and building our Medicare rental business in the United States. In April 2009, we became a Durable, Medical Equipment, Prosthetics, Orthotics, and Supplies accredited Medicare supplier by the Accreditation Commission for Health Care. We believe that we were the first oxygen therapy manufacturer to employ a direct-to-consumer marketing strategy, meaning we advertise directly to patients, process their physician paperwork, and provide clinical support as needed, which we believe has contributed to our market leadership position in the portable oxygen concentrator market. While other manufacturers have also begun direct-to-consumer marketing campaigns to drive patient sales, we believe we are the only portable oxygen concentrator manufacturer that employs a direct-to-consumer rental strategy in the United States, meaning we bill Medicare or insurance on the consumer's behalf.

We derive the majority of our revenue from the sale and rental of our Inogen One systems and related accessories to patients, insurance carriers, home healthcare providers and distributors, including our private label partner. We sell multiple configurations of our Inogen One and Inogen At Home systems with various batteries, accessories, warranties, power cords and language settings. We also rent our products to Medicare beneficiaries and patients with other insurance coverage to support their long-term oxygen needs as prescribed by a physician as part of a care plan. Our goal is to design, build and market oxygen solutions that redefine how long-term oxygen therapy is delivered. To accomplish this goal and to grow our revenue, we intend to:

- *Expand our domestic sales and marketing channels.* During the year ended December 31, 2018, we increased our inside sales representatives to 446 from 263 as of December 31, 2017 in support of our direct-to-consumer domestic sales. We also opened a new facility in Cleveland, Ohio in the third quarter of 2017. In that facility, we had 333 employees as of December 31, 2018. We have been and plan to continue focusing on improving the productivity of our sales team, while also creating a separate rental team who will focus exclusively on new rental additions to drive overall sales productivity. However, the level of attrition was higher than expected in the six months ended June 30, 2019 as many sales representatives were unable to meet our sales targets. The sales representative average headcount was down approximately 17% for the three months ended June 30, 2019 compared to the three months ended June 30, 2018 and down significantly compared to the headcount at December 31, 2018. We have restarted our sales capacity expansion efforts with new sales representatives hired across all three facilities already in August 2019. Going forward, we plan to hire at a more controlled pace than we did in 2018 to expand sales capacity, but we expect sales representative headcount to be down significantly at year-end 2019 compared to year-end 2018. Given the reduced sales representative headcount, we expect to realize headwinds to growth in direct-to-consumer sales in 2019. We believe we are making the necessary changes to improve sales management infrastructure to support sales representative training and onboarding and have made key changes to management personnel. We believe we will see increased productivity of our sales representatives throughout 2019, however we also expect increased marketing spend.

While we have slightly changed our rental intake criteria to increase net rental patient additions, since rental reimbursement revenue is recognized monthly, compared to the mostly immediate revenue recognition of direct-to-consumer sales, we do not expect a meaningful rental revenue benefit from increasing new rental setups until next year and beyond and expect rental revenue to decline in 2019 as compared to 2018. While we expect rental revenue to take time to ramp, we believe we can improve our close rate and lead usage by slightly altering our intake criteria for rental patients. Historically our minimum billable months threshold was high, which limited the number of patients we accepted through insurance. We have lowered this monthly threshold to improve sales representative productivity and lead usage. In focusing more on rentals, this could have an adverse impact on near term sales revenue in the US, but we believe it will lead to increased marketing conversion rates and increased portable oxygen concentrator adoption. We believe patients on service will increase in the back-half of 2019, and we expect both patients on service and rental revenue to increase in 2020.

We are also focused on building our domestic business-to-business partnerships, including relationships with distributors, key accounts, resellers, our private label partner, and traditional home medical equipment (HME) providers. We launched Inogen Capital, an HME-focused financing program, in the fourth quarter of 2018, which we believe will support HME providers in securing financing to help convert their businesses to a non-delivery portable oxygen concentrator business model. Inogen Capital is financed through a third party to provide direct lease financing between the third party and our HME customer with no recourse obligation to us for events of default. We believe Inogen Capital will be a valuable tool for smaller homecare providers that have historically been capital constrained.

While HME providers have been adopting our products, we expect growth will be challenged due to challenges in their ongoing efforts to restructure from the delivery model business model to the portable model, lack of access to available credit, and provider capital expenditure constraints. Additionally, we believe providers will be more conservative with investment in the next year due to pending competitive bidding Round 2021 and the lack of visibility to who will win contracts and any change in reimbursement rates. Home medical equipment providers have also communicated to us that they continue to be subject to capital constraints and certain providers have indicated that they intend to reduce or limit purchases in the future. We also have seen a slowing of growth in orders from our internet reseller partners, which may limit our growth prospects.

- *Invest in our product offerings to develop innovative products* We expended $1.5 million and $1.8 million for the three months ended June 30, 2019 and June 30, 2018, respectively, and $3.1 million and $3.2 million for the six months ended June 30, 2019 and June 30, 2018, respectively, in research and development expenses, and we intend to continue to make such investments in the foreseeable future. We launched our fifth-generation portable oxygen concentrator, the Inogen One G5, in April 2019 in our direct-to-consumer channel, and we expect to launch the product in our domestic business-to-business channel in the third quarter of 2019 and in our international channels by year-end 2019, pending standard regulatory clearances in each market. The Inogen One G5 weighs 4.7 pounds, and produces 1,260 ml per minute of oxygen output, with very quiet operation at 38 dBA and our longest battery life at 6.5 hours for a single battery and up to 13 hours for a double battery. We estimate that the Inogen One G5 is suitable for 95% of ambulatory long-term oxygen therapy patients based on our analysis of the patients who have contacted us and their clinical needs. We expect the Inogen One G5 to obsolete the Inogen One G3 over the intermediate term. At volume, we expect the Inogen One G5 to be our lowest cost product to manufacture.

  We launched our fourth-generation portable oxygen concentrator, the Inogen One G4, in May 2016. The Inogen One G4 weighs 2.8 pounds, versus 4.8 pounds for our Inogen One G3, and is approximately half the size of the Inogen One G3. The sound level is 40 dBA at setting 2 and it produces up to 630 ml per minute of oxygen output. The Inogen One G4 system is also less expensive to manufacture than our Inogen One G3 system.

  We launched Inogen Connect, our new connectivity platform on our Inogen One G4 system in the fourth quarter of 2018 in the direct-to-consumer channel and in the domestic business-to-business channel in the first quarter of 2019, and we launched Inogen Connect in our Inogen One G5 at launch of the product in the United States. Inogen Connect is compatible with Apple and Android platforms and includes patient features such as purity status, battery life, product support functions, notification alerts, and remote software updates. We believe home oxygen providers will also find features such as remote troubleshooting, equipment health checks, and location tracking to help drive operational efficiencies when transitioning away from the oxygen tank delivery model.

  On August 7, 2019, we announced that we entered into a definitive agreement to acquire New Aera, Inc. (New Aera), which is expected to close in August 2019. New Aera's patented and FDA cleared Tidal Assist® Ventilator (TAV®) system is designed to deliver increased flow and pressure from an approximately 4-ounce pocket-size unit, features a state-of-the-art nasal pillow interface, and is compatible with certain oxygen concentrators, oxygen cylinders, wall gas, and certain medical air sources. TAV therapy with oxygen has been clinically demonstrated during periods of exercise to reduce breathlessness, increase exercise endurance, and improve oxygen saturation for patients suffering from certain chronic lung disease compared to oxygen therapy alone. We plan to incorporate the TAV technology directly into our Inogen One portable oxygen concentrators and make the SideKick TAV product compatible with our Inogen At Home stationary concentrator to continue to advance patient preference and maintain our technology leadership position in the long-term oxygen therapy market.

In addition, we plan to use this technology as a platform to expand our total addressable market into the high-growth non-invasive ventilation (NIV) market where we believe there is a significant worldwide untreated market opportunity. We believe this market could undergo disruption similar to oxygen given the pending reimbursement changes due to the inclusion of this category in competitive bidding round 2021 and the immobile nature of legacy NIV product offerings. The monthly Medicare reimbursement rate is significantly higher for NIV products than oxygen therapy at a minimum of $934 a month. Also, effective January 1, 2019, a new Medicare HCPCS code has been added to allow billing for a multi-function ventilator that includes both ventilation and oxygen. We are targeting to launch a product for this purpose in 2021.

- *Increase international business-to-business adoption.* Although our main growth opportunity remains portable oxygen concentrator adoption in the United States given what we still believe is a relatively low penetration rate, we are keenly aware of the large international market opportunity. In order to take advantage of these international opportunities, we have built out an infrastructure over the past few years, which includes sales in 46 international countries and a contract manufacturing partner, Foxconn, located in the Czech Republic to support European sales volumes. Further, we are also in the process of developing regulatory and sales pathways to capture opportunities in new and emerging markets. We expect to enter the Chinese market by year-end 2020. Over time, as the U.S. and European markets mature, our growth will depend on our ability to drive portable oxygen concentrator adoption in emerging markets, where limited oxygen therapy treatment exists today. However, growth may also be limited by currency fluctuations.

We have been developing and refining the manufacturing of our Inogen One systems since 2004. While nearly all of our manufacturing and assembly processes were originally outsourced, assembly of the compressors, sieve beds, concentrators and certain manifolds were brought in-house in order to improve quality control and reduce cost. In support of our European sales, we established a physical presence in Europe by acquiring our former distributor, MedSupport Systems B.V. (MedSupport), on May 4, 2017 and began production of our Inogen One G3 concentrators in the fourth quarter of 2017 using a contract manufacturer, Foxconn, located in the Czech Republic to improve our ability to service our European customers. We expect to maintain our assembly operations for our Inogen One concentrators and Inogen At Home concentrators at our facilities in Richardson, Texas and Goleta, California.

We also use lean manufacturing practices to maximize manufacturing efficiency. We rely on third-party manufacturers to supply several components of our Inogen One and Inogen At Home systems. We typically enter into supply agreements for these components that specify quantity and quality requirements and delivery terms. In certain cases, these agreements can be terminated by either party upon relatively short notice. We have elected to source certain key components from single sources of supply, including our batteries, motors, valves, and some molded plastic components. We believe that maintaining a single source of supply allows us to control production costs and inventory levels and to manage component quality. However, any reduction or halt in supply from one of these single-source suppliers could limit our ability to manufacture our products or devices until a replacement supplier is found and qualified.

Historically, we have generated a majority of our revenue from sales and rentals to customers in the United States. In the three months ended June 30, 2019 and June 30, 2018, approximately 22.3% and 21.3%, respectively, and 22.2% and 21.4% for the six months ended June 30, 2019 and June 30, 2018, respectively, of our total revenue was from sales to customers outside the United States, primarily in Europe. Approximately 71.8% and 76.0% of the non-U.S. revenue for the three months ended June 30, 2019 and June 30, 2018, respectively, and 71.6% and 76.4% for the six months ended June 30, 2019 and June 30, 2018, respectively, was invoiced in Euros with the remainder invoiced in United States dollars. We sell our products in 46 countries outside the United States through our wholly owned subsidiary, distributors or directly to large “house” accounts, which include gas companies, HME oxygen providers, and resellers. In those instances, we sell to and bill the distributor or “house” accounts directly, leaving responsibility for the patient billing, support and clinical setup to the local provider.

Our total revenue was $101.1 million and $97.2 million for the three months ended June 30, 2019 and June 30, 2018, respectively, and $191.3 million and $176.3 million for the six months ended June 30, 2019 and June 30, 2018, respectively. The increase in both periods was primarily due to growth in sales revenue associated with the increases in direct-to-consumer and international business-to-business sales, partially offset by a decline in domestic business-to-business sales. We generated net income of $10.2 million and $14.6 million for the three months ended June 30, 2019 and June 30, 2018, respectively, and $15.5 million and $25.4 million for the six months ended June 30, 2019 and June 30, 2018, respectively. We generated Adjusted EBITDA of $16.8 million and $19.0 million in the three months ended June 30, 2019 and June 30, 2018, respectively, and $27.9 million and $34.5 million for the six months ended June 30, 2019 and June 30, 2018, respectively, (see “Non-GAAP financial measures” for reconciliations between U.S. GAAP and non-GAAP results). As of June 30, 2019, our retained earnings were $75.9 million.

Recent developments

On August 7, 2019, we announced that we had entered into a definitive agreement to acquire New Aera, an innovative developer and manufacturer of portable non-invasive ventilators for people suffering from various chronic lung diseases. In connection with the acquisition, we will also separately acquire certain intellectual property assets from an affiliate of New Aera. In the short to intermediate term, we plan to sell TAV systems through our domestic direct-to-consumer sales channel and our business-to-business sales channels worldwide, pending regulatory clearances outside of the United States. We also plan to incorporate the TAV technology directly into our Inogen One portable oxygen concentrators to continue to advance patient preference and maintain our technology leadership position. The consideration for the transaction consists of an approximately $70.4 million in cash, subject to customary purchase price and escrow adjustments, and potential earn-out payments of up to $31.4 million based on future sales performance and certain regulatory clearances. The transaction will be a use of Inogen's current cash and marketable securities and is expected to close in August 2019.

Sales revenue

Our future financial performance will be driven in part by the growth in sales of our Inogen One systems, and, to a lesser extent, sales of batteries, other accessories, and sales of our Inogen At Home stationary oxygen concentrators. We plan to grow our system sales in the coming years through multiple strategies including: expanding our direct-to-consumer sales efforts through hiring additional sales representatives, productivity improvements in our direct-to-consumer sales team, creating a separate rental team who will focus exclusively on new rental additions to drive overall sales productivity, investing in consumer awareness through increased marketing efforts, expanding our sales infrastructure and efforts outside of the United States, expanding our business-to-business sales through key partnerships, and enhancing our product offerings through additional product launches. While HME providers continue to convert and purchase portable oxygen concentrators, we expect growth will be challenged due to ongoing restructure efforts, lack of access to available credit, and provider capital expenditure constraints. Additionally, we believe providers will be more conservative with investment in the next year due to pending competitive bidding Round 2021 and the lack of visibility to who will win contracts and any change in reimbursement rates. Even though we still believe the market is underpenetrated and patient demand is strong, we are lowering growth expectations for HME providers and internet resellers given these challenges and uncertainties. As our product offerings grow, we solicit feedback from our customers and focus our research and development efforts on continuing to improve patient preference and reduce the total cost of the product in order to further drive sales of our products. For example, in the second quarter of 2018, we completed a direct-to-consumer pricing elasticity trial which indicated that by lowering our price we can expand access to our products and increase sales volumes while also improving our total gross margin profile. Accordingly, as of June 1, 2018, we reduced the starting retail minimum advertised price for our Inogen One G3 and Inogen One G4 systems.

Our direct-to-consumer sales process involves numerous interactions with the individual patient, the physician and the physician's staff, and includes an in-depth analysis and review of our product, the patient's diagnosis and prescribed oxygen therapy, including procuring an oxygen prescription. The patient may consider whether to finance the product through an Inogen-approved third-party or purchase the equipment. Product is not deployed until both the prescription and payment are received. Once a full system is deployed, the patient has 30 calendar days to return the product, subject to the payment of a minimal processing and handling fee. Approximately 6-12% of consumers who purchase a system return the system during this 30-day return period.

Our business-to-business efforts are focused on selling to distributors, HME oxygen providers, our private label partner and resellers, who are based inside and outside of the United States. This process involves interactions with various key customer stakeholders including sales, purchasing, product testing, and clinical personnel. Businesses that have patient demand that can be met with our oxygen concentrator systems place purchase orders to secure product deployment. This may be influenced based on outside factors, including the result of tender offerings, changes in insurance plan coverage, business restructuring activities toward a non-delivery oxygen model, capital constraints, and overall changes in the net long-term oxygen therapy patient population. Products are shipped freight on board (FOB) Inogen dock domestically, and based on financial history and profile, businesses may either prepay or receive extended payment terms. Products are shipped both FOB Inogen dock and Delivery Duty Paid (DDP) for certain international shipments depending on the shipper used. DDP shipments are Inogen's property until title has transferred which is upon duty being paid and delivered to the customer. As a result of these factors, product purchases can be subject to changes in demand by customers.

We sold approximately 56,500 systems in the three months ended June 30, 2019 compared to 54,700 systems for the same period in 2018. We sold approximately 106,900 systems in the six months ended June 30, 2019 compared to 100,100 systems for the same period in 2018. Management focuses on system sales as an indicator of current business success.

Rental revenue

Our direct-to-consumer rental process involves numerous interactions with the individual patient, the physician and the physician's staff. The process includes an in-depth analysis and review of our product, the patient's diagnosis and prescribed oxygen therapy, and their medical history to confirm the appropriateness of our product for the patient's oxygen therapy and compliance with Medicare and private payor billing requirements, which often necessitates additional physician evaluation and/or testing as well as a Certificate of Medical Necessity. Once the product is deployed, the patient receives direction on product use and may receive a clinical titration from our licensed staff to confirm the product meets the patient's medical oxygen needs prior to billing. As a result, the time from initial contact with a patient to billing can vary significantly and be up to one month or longer.

We expect rental revenue to modestly decline in 2019 as compared to 2018 in spite of the slight change to our intake criteria on rental patients that we made in the second quarter of 2019, primarily due to fewer new rental setups due to reduced sales capacity, an additional 3.9% reduction in Medicare reimbursement rates for our products effective January 1, 2019, and the adoption of ASU No. 2018-19 that requires reclassification of rental bad debt expense to be charged to rental revenue. We plan to add new rental patients on service in future periods through multiple strategies, including creating a rental intake team focused on adding rental patients, expanding our direct-to-consumer marketing efforts, investing in patient and physician awareness, and securing additional insurance contracts. However, insurance reimbursement rates are expected to decline. In addition, patients may come off our services due to death, a change in their condition, a change in location, a change in healthcare provider or other factors. In each case, we maintain asset ownership and can redeploy assets as appropriate following such events. Given the length and uncertainty of our patient acquisition cycle and potential returns we have experienced in the past, and likely will experience in the future, fluctuations in our net new patient setups will occur on a period-to-period basis and we may experience negative net patient additions in future periods. At this time, we do not plan to offer our Inogen One G5 and Inogen One G4 systems to rental patients but will continue to use the Inogen One G3 system as the primary ambulatory solution deployed in our rental fleet. We plan to use the Inogen One G5 system in our rental fleet once production of the Inogen One G3 system is discontinued.

A portion of rentals include a capped rental period during which no additional reimbursement is allowed unless additional criteria are met. In this scenario, the ratio of billable patients to total patients on service is critical to maintaining rental revenue growth as patients on service increases. Medicare has noted a certain percentage of beneficiaries, approximately 25%, based on their review of Medicare claims, reach the 36th month of eligible reimbursement and enter the capped rental period. Our capped patients as a percentage of total patients on service was approximately 20.2% as of June 30, 2019 compared to approximately 17.7% as of June 30, 2018. The percentage of capped patients may fluctuate over time as new patients come on service, patients come off of service before and during the capped rental period, and existing patients enter the capped rental period.

We had approximately 25,900 and 28,500 oxygen rental patients as of June 30, 2019 and June 30, 2018, respectively. Management focuses on patients on service as a leading indicator of likely future rental revenue; however, actual rental revenue recognized is subject to a variety of other factors, including reimbursement levels by payor, patient location, the number of capped patients, write-offs for uncollectable balances, and rental revenue adjustments.

Reimbursement

We rely heavily on reimbursement from Medicare, and secondarily, from private payors, including Medicare Advantage plans, Medicaid and patients for our rental revenue. For the three months and six months ended June 30, 2019, approximately 80.9% and 80.8%, respectively, of our rental revenue was derived from Medicare's traditional fee-for-service reimbursement programs. The U.S. list price for our stationary oxygen rentals (HCPCS E1390) is $260 per month and the U.S. list price for our oxygen generating portable equipment (OGPE) rentals (HCPCS E1392) is $70 per month. The average Medicare reimbursement rates in competitive bidding areas in 2018 were $77.03 a month for E1390 and $36.06 a month for E1392. These are the two primary codes that we bill to Medicare and other payors for our oxygen product rentals.

Effective January 1, 2019, Medicare beneficiaries may receive durable medical equipment from any Medicare-enrolled supplier until new contracts are awarded for the competitive bidding Round 2021, which is expected to begin on January 1, 2021. Reimbursement rates between January 1, 2019 and December 31, 2020 are set at the current pricing level throughout the United States for all Medicare patients, subject to Consumer Price Index (CPI) and budget neutrality adjustments. Pricing in competitive bidding areas is subject to annual CPI adjustments beginning in 2019 until Round 2021 begins. However, Centers for Medicare and Medicaid Services (CMS) also changed the calculation on budget neutrality to apply the offset to all oxygen and oxygen equipment classes beginning January 1, 2019 instead of previously only applying these adjustments to stationary oxygen equipment and oxygen contents. Based on these CPI and budget neutrality adjustments, effective January 1, 2019, the average Medicare reimbursement rates were reduced to $72.92 a month for E1390 and $35.72 a month for E1392 in these regions that were previously subject to competitive bidding. Medicare also established new payment classes for liquid oxygen equipment and high flow portable liquid oxygen contents effective January 1, 2019.

In the next round of durable medical equipment, prosthetics, orthotics and supplies (DMEPOS) competitive bidding program, there have been some revisions to the bidding methodology including the plan to implement bid surety bond requirements, lead item pricing, and setting reimbursement rates at the maximum winning bid rate instead of the median winning bid rate. In the prior round of competitive bidding, the product category where our products fell was respiratory equipment and related supplies and accessories, which included oxygen equipment, continuous positive airway pressure (CPAP) devices and respiratory assist devices (RADs) and related supplies and accessories. In the next round of the competitive bidding program, oxygen and oxygen equipment is its own product category and the lead item has been established as E1390. However, due to the lead item pricing methodology based on the 2015 standard Medicare fee schedule, E1392 reimbursement rates could be reduced significantly (we estimate approximately 42%) even if E1390 reimbursement rates do not change. This would lead to combined E1390 plus E1392 reimbursement rates to decrease by approximately 15% The bidding window opened on July 16, 2019 and we plan on bidding in 129 of the 130 total Competitive Bidding Areas (CBAs). It is unclear how pricing will be impacted due to these new bids. We expect contracts and pricing to be announced in 2020.

In addition to regional pricing, CMS imposed different pricing on "frontier states" and rural areas. CMS defines frontier states as states where more than 50% of the counties in the state have a population density of 6 people or less per square mile and rural states are defined as states where more than 50% of the population lives in rural areas per census data. Current frontier states include MT, ND, SD and WY; rural states include ME, MS, VT and WV; and non-contiguous United States areas include AK, HI, Guam and Puerto Rico. Effective June 1, 2018 through December 31, 2020, for frontier and rural states, frontier and rural zip codes in non-frontier/rural states and non-contiguous United States areas, the single payment amount will be 50/50 blended reimbursement rates based on an average of the pre-competitive bidding reimbursement rates and the current average reimbursement rates to account for higher servicing costs in these areas. In 2019, this rate is $134.71 a month for E1390 and $44.32 a month for E1392. We estimate that less than 10% of our patients are eligible to receive the higher reimbursement rates based on the geographic locations of our current patient population.

Cumulatively in previous rounds of competitive bidding, we were offered contracts for a substantial majority of CBA and product categories for which we submitted bids. As of January 1, 2017, we believe we had access to over 90% of the Medicare oxygen therapy market based on our analysis of the 103 CBAs that we won out of the 130 total CBAs. These 130 CBAs represent approximately 39% of the market with the remaining approximately 61% of the market not subject to competitive bidding per Medicare's data on 2017 traditional Medicare fee-for-service beneficiaries in CBAs as compared to the total Medicare fee-for-service beneficiaries. As of January 1, 2019, we can choose to accept Medicare oxygen patients throughout the United States. As of July 2018, we are operating in all 50 states in the U.S. We did not sell or rent to patients in Hawaii due to the licensure requirements from inception to June 2018.

We cannot guarantee that we will be offered contracts in subsequent rounds of competitive bidding. In all five rounds of competitive bidding in which we have participated, we have gained access to certain CBAs and been excluded from other CBAs.

Medicare revenue, including patient co-insurance and deductible obligations, represented 4.1% and 4.5% of our total revenue in the three months and six months ended June 30, 2019, respectively.

Medicare reimbursement for oxygen rental equipment is limited to a maximum of 36 months within a 60-month service period, and the equipment remains the property of the home oxygen supplier. The supplier that billed Medicare for the 36th month of service continues to be responsible for the patient's oxygen therapy needs for months 37 through 60, and there is generally no additional reimbursement for oxygen generating portable equipment for these later months. Medicare does not separately reimburse suppliers for oxygen tubing, cannulas and supplies that may be required for the patient. The supplier is required to keep the equipment provided in working order and in some cases, Medicare will reimburse for repair costs. At the end of the five-year useful life of the equipment, the patient may request replacement equipment and, if he or she can be re-qualified for the Medicare benefit, a new maximum 36-month payment cycle out of the next 60 months of service would begin. The supplier may not arbitrarily issue new equipment. We have analyzed the potential impact to revenue associated with patients in the capped rental period and have deferred $0 associated with the capped rental period for the three months and six months ended June 30, 2019 and June 30, 2018, respectively. Our capped patients as a percentage of total patients on service was approximately 20.2% as of June 30, 2019, which was higher than the capped patients as a percentage of total patients on service of approximately 17.7% as of June 30, 2018. The percentage of capped patients may fluctuate over time as new patients come on service, patients come off of service before and during the capped rental period, and existing patients enter the capped rental period.

Our obligations to service Medicare patients over the rental period include supplying working equipment that meets each patient's oxygen needs pursuant to his/her doctor's prescription and certificate of medical necessity form and supplying all disposables required for the patient to operate the equipment, including cannulas, filters, replacement batteries, carts and carry bags, as needed. If the equipment malfunctions, we must repair or replace the equipment. We determine what equipment the patient receives, as long as that equipment meets the physician's prescription, and we can deploy used assets in working order as long as the prescription requirements are met. We must also procure a recertification of the certificate of medical necessity from the patient's doctor to confirm the patient's need for continued oxygen therapy one year after the patient first receives oxygen therapy and one year after each new 36-month reimbursement period begins. The patient can choose to receive oxygen supplies and services from another supplier at any time, but the supplier may only transition the patient to another supplier in certain circumstances.

CMS issued a final rule to require Medicare prior authorization (PA) for certain durable medical equipment, prosthetics, orthotics, and supplies (DMEPOS) that the agency characterizes as "frequently subject to unnecessary utilization". The final rule was published on December 30, 2015 and specified an initial master list of 135 items that could potentially be subject to PA. Initially stationary oxygen rentals (code E1390) was included on the master list, but it was later removed. On April 22, 2019, stationary oxygen rentals (E1390) was again added to the list of potential codes that could be subject to PA. The master list is updated annually and published in the Federal Register. The presence of an item on the master list does not automatically mean that a PA is required. CMS will select a subset of these master list items for its "Required Prior Authorization List". There will be a notice period of at least 60 days prior to implementation. The ruling does not create any new clinical documentation requirements; instead the same information necessary to support Medicare payment will be required *prior* to the item being furnished to the beneficiary. CMS has proposed that reasonable efforts are made to provide a PA decision within 10 days of receipt of all applicable information, unless this timeline could seriously jeopardize the life or health of the beneficiary or the beneficiary's ability to regain maximum function, in which case the proposed PA decision would be 2 business days. CMS will issue additional sub regulatory guidance on these timelines in the future.

On May 15, 2019, a bi-partisan bill (H.R. 2771) was introduced in the House of Representatives that would provide relief from competitive bidding in non-bid areas. This bill has 32 co-sponsors as of August 1, 2019. If passed, the bill would provide retroactive relief to rural areas by making the 50/50 blended reimbursement rate in rural and noncontiguous areas permanent and by introducing a 75/25 blended reimbursement rate for areas other than rural and noncontiguous. The legislation also proposes to remedy a double-dip cut to oxygen payments caused by the misapplication of a 2006 budget neutrality offset balancing increased utilization for oxygen generating portable equipment with lower reimbursement for stationary equipment. There is no known timing on voting on this bill.

On March 11, 2019, the current presidential administration sent Congress a 2020 budget proposal that included language on competitive bidding. Specifically, the proposal would eliminate the requirement under the competitive bidding program that CMS pay a single payment amount based on the median bid price, proposing instead that CMS pay winning suppliers at their own bid amounts. Additionally, this proposal would expand competitive bidding to all areas of the country, including rural areas, which will be based on competition in those areas rather than on competition in urban areas. This specific proposal is estimated to save the government $7.1 billion in Medicare savings and $0.4 billion in Medicaid savings over 10 years. In addition to changes to competitive bidding, the 2020 budget proposal would enable CMS not to impose the face-to-face requirement on all providers for durable medical equipment. Furthermore, the proposal seeks to address excessive billing of durable medical equipment that requires refills or serial claims. Specifically, Medicare would gain authority to test whether using a benefits manager for serial durable medical equipment claims would result in lower improper payments and reductions in inappropriate utilization. The benefits manager would be responsible for ensuring beneficiaries were receiving the correct quantity of supplies or service for the appropriate time period. In addition, the proposal allows an administrative penalty of $50 for Part B items/services and $100 for Part A services on providers for ordering high-risk, high-cost items or services without proper documentation, such as diagnosis or encounter data. Lastly, the proposal would expand prior authorization to additional items and services that are both high-cost and at high-risk for improper payments. These provisions were not included in the latest omnibus budget, so it is unclear if any of these proposals will be implemented. We believe additional cuts to reimbursement would continue to drive conversion to non-delivery technologies, including portable oxygen concentrators (POC), however this could also exacerbate patient access issues for treatment.

On July 29, 2019, CMS issued a proposed rule to establish methodologies to modernize pricing of new DMEPOS items and services based on commercial pricing data. In addition, the proposed rule recommends streamlining requirements related to face-to-face encounters, written orders prior to delivery and/or prior authorizations to reduce provider confusion. Lastly, the proposed rule recommends revising the existing DMEPOS competitive bidding program regulations to recognize that changes of ownership may occur on shorter timeframes and revising the submission of a hearing request in notices of breach of contract. CMS is soliciting comments on this proposed rule through September 27, 2019.

As of June 30, 2019, we had 91 contracts with Medicaid, Medicare Advantage, and private payors. These contracts qualify us as an in-network provider for these payors. As a result, patients can rent or purchase our systems at the same patient obligation as other in-network oxygen suppliers. Based on our patient population, we believe more than 40% of all oxygen therapy patients are covered by Medicare Advantage and other private payors. Private payors typically provide reimbursement at a rate similar to Medicare allowable for in-network plans. We anticipate that private payor reimbursement levels will generally be reset in accordance with Medicare payment amounts.

We cannot predict the full extent to which reimbursement for our products will be affected by competitive bidding, the 2019 federal budget or future federal budgets, prior authorization requirements, or by initiatives to reduce costs for private payors. We believe that we are well positioned to respond to the changing reimbursement environment because our product offerings are innovative, patient-focused and cost-effective. We have historically been able to reduce our costs through scalable manufacturing, better sourcing, continuous innovation, and reliability improvements, as well as innovations that reduce our product service costs by minimizing exchanges, such as user replaceable batteries. As a result of design changes, supplier negotiations, bringing manufacturing and assembly largely in-house and our commitment to driving efficient manufacturing processes, we have reduced our overall system cost 58% from 2009 to 2018. We intend to continue to seek ways to reduce our cost of revenue through manufacturing and design improvements.

For additional discussion of the impact of the recent Medicare reimbursement proposals, see "Risk Factors" herein.

Basis of presentation

The following describes the line items set forth in our consolidated statements of comprehensive income.

Revenue

We classify our revenue in two main categories: sales revenue and rental revenue. There will be fluctuations in mix between business-to-business sales, direct-to-consumer sales and rental revenue from period-to-period. Inogen One and Inogen At Home system selling prices and gross margins may fluctuate as we introduce new products, reduce our product costs, have changes in purchase volumes, and as currency variations occur. For example, the gross margin for our Inogen One G4 system is higher than our Inogen One G3 system due to lower manufacturing costs and similar average selling prices. Thus, to the extent our sales of our Inogen One G4 systems are higher than sales of our Inogen One G3 systems, our overall gross margins should improve and, conversely, to the extent our sales of our Inogen One G3 systems are higher than sales of our Inogen One G4 systems, our overall gross margins should decline. Quarter-over-quarter results may vary due to seasonality in both the international and domestic markets. For example, we typically experience higher total sales in the second and third quarter, as a result of consumers traveling and vacationing during warmer weather in the spring and summer months, but this may vary year-over-year. As more HME providers adopt portable oxygen concentrators in their businesses, we expect our historical seasonality in the domestic business-to-business channel could change as well, which was previously influenced mainly by consumer buying patterns. Direct-to-consumer sales seasonality may also be impacted by the number of sales representatives, sales representative productivity, and the amount of marketing spend in each quarter.

Sales revenue

Our sales revenue is primarily derived from the sale of our Inogen One systems, Inogen At Home systems, and related accessories to individual consumers, our private label partner, HME providers, distributors and resellers worldwide. Sales revenue is classified into two areas: business-to-business sales and direct-to-consumer sales. For the three months ended June 30, 2019 and June 30, 2018, business-to-business sales as a percentage of total sales revenue were 54.5% and 58.4%, respectively. For the six months ended June 30, 2019 and June 30, 2018, business-to-business sales as a percentage of total sales revenue were 54.3% and 59.6%, respectively. Generally, our direct-to-consumer sales have higher gross margins than our business-to-business sales.

We also offer a lifetime warranty for direct-to-consumer sales of our oxygen concentrators. For a fixed price, we agree to provide a fully functional oxygen concentrator for the remaining life of the patient. Lifetime warranties are only offered to patients upon the initial sale of oxygen concentrators by the Company and are non-transferable. Lifetime warranties are considered to be a distinct performance obligation that are accounted for separately from the sale of oxygen concentrators with a standard warranty of three years.

The revenue is allocated to the distinct lifetime warranty performance obligation based on a relative stand-alone selling price (SSP) method. We have vendor-specific objective evidence of the selling price for our equipment. To determine the selling price of the lifetime warranty, we use our best estimate of the SSP for the distinct performance obligation as the lifetime warranty is neither separately priced nor is the selling price available through third-party evidence. To calculate the selling price associated with the lifetime warranties, management considers the profit margins of service revenue, the average estimated cost of lifetime warranties and the price of extended warranties. Revenue from the distinct lifetime warranty is deferred after the delivery of the equipment and recognized based on an estimated mortality rate over five years, which is the estimated performance period of the contract based on the average patient life expectancy.

Revenue from the sale of our repair services is recognized when the performance obligations are satisfied, and collection of the receivables is probable. Other revenue from sale of replacement parts is generally recognized when product is shipped to customers.

Rental revenue

Our rental revenue is primarily derived from the rental of our Inogen One and Inogen At Home systems to patients through reimbursement from Medicare, private payors and Medicaid, which typically also includes a patient responsibility component for patient co-insurance and deductibles. We expect our rental revenue to modestly decline in 2019 in spite of the slight change to our intake criteria on rental patients that we made in the second quarter of 2019, primarily due to lower new rental setups due to reduced sales capacity, an additional 3.9% reduction in Medicare reimbursement rates for our products effective January 1, 2019 and the adoption of ASU No. 2018-19 that requires reclassification of rental bad debt expense to be charged to rental revenue. We also expect that our rental revenue will be impacted by the number of sales representatives, the number of rental intake representatives, the level of and response from potential customers to direct-to-consumer marketing spend, product launches, and other uncontrollable factors such as changes in the market and competition.

We recognize equipment rental revenue over the non-cancelable lease term, which is one month, less estimated adjustments, in accordance with Accounting Standards Codification (ASC) 842 — *Leases*. We have a separate contract with each patient that is not subject to a master lease agreement with any payor. The lease term begins on the date products are shipped to patients and is recorded at amounts estimated to be received under reimbursement arrangements with third-party payors, including Medicare, private payors, and Medicaid. Due to the nature of the industry and the reimbursement environment in which we operate, certain estimates are required to record net revenue and accounts receivable at their net realizable values. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available. Specifically, the complexity of many third-party billing arrangements and the uncertainty of reimbursement amounts for certain services from certain payors may result in adjustments to amounts originally recorded. Such adjustments are typically identified and recorded at the point of cash application, claim denial or account review. Amounts billed but not earned due to the timing of the billing cycle are deferred and recognized in revenue on a straight-line basis over the monthly billing period. For example, if the first day of the billing period does not fall on the first of the month, then a portion of the monthly billing period will fall in the subsequent month and the related revenue and cost would be deferred based on the service days in the following month. Included in rental revenue are unbilled amounts for which the revenue recognition criteria had been met as of period-end but were not billed. The estimate of unbilled rental revenue accrual is reported net of adjustments that are based on historical trends and estimates of future collectability.

Cost of revenue

Cost of sales revenue

Cost of sales revenue consists primarily of costs incurred in the production process, including costs of component materials, assembly labor and overhead, warranty, provisions for slow-moving and obsolete inventory, rework and delivery costs for items sold. Labor and overhead expenses consist primarily of personnel-related expenses, including wages, bonuses, benefits, and stock-based compensation for manufacturing, logistics, repair and manufacturing engineering quality assurance employees, and temporary labor. Cost of sales revenue also includes manufacturing freight in, depreciation expense, facilities costs and materials. We provide a 3-year, 5-year or lifetime warranty on Inogen One systems sold and a 3-year and lifetime warranty on Inogen At Home systems sold. We establish a reserve for the cost of future warranty repairs based on historical warranty repair costs incurred as well as historical failure rates. Provisions for warranty obligations, which are included in cost of sales revenue, are provided for at the time of revenue recognition.

We continue to make progress towards reducing the average unit costs of our Inogen One and Inogen At Home systems as a result of our ongoing efforts to develop lower-cost systems, negotiations with our suppliers, improvements in our manufacturing processes, and increased production volume and yields. In the second quarter of 2018, we also signed an additional lease in Richardson, Texas to expand our current manufacturing facilities by approximately 23,000 square feet to enable increased production volumes. At the same time, recent United States policies related to global trade and tariffs may also increase the Company’s average unit cost.

The current economic environment has introduced greater uncertainty with respect to potential trade regulations, including changes to United States policies related to global trade and tariffs. The Company continues to monitor the recently announced Section 301 tariffs being imposed by the United States on certain imported Chinese materials and products in addition to potential retaliatory responses from other nations. Assuming the Chinese tariffs stay at the current 25% rate, we currently expect the overall financial impact to our business to be a small increase to the average unit cost for 2019. On August 1, 2019, the current administration announced new 10% tariffs on up to $300 billion in additional goods imported from China effective September 1, 2019. We are still evaluating the impact of these tariffs on our financial results, but we believe additional components used in our Inogen One systems will be subject to these additional tariffs, which could increase our costs.

We expect the TAV system to have a higher sales gross margin than our existing oxygen therapy business.

For these reasons, we expect sales gross margin percentage to fluctuate over time based on the sales channel mix, product mix, and changes in average selling prices and cost per unit.

Cost of rental revenue

Cost of rental revenue consists primarily of depreciation expense; service costs for rental patients, including rework costs, material, labor, freight, and consumable disposables; and logistics costs.

We expect rental gross margin percentage to stay relatively flat in 2019 compared to 2018, primarily associated with higher rental revenue per patient, partially offset by higher service costs. We expect the average cost of rental revenue per patient to decline in future periods as a result of our ongoing efforts to reduce the average unit cost of our system, as well as reductions in depreciation, service costs, and logistics costs.

We expect the TAV system to have a higher rental gross margin than our existing oxygen therapy business.

Operating expense

Research and development

Our research and development expense consists primarily of personnel-related expenses, including wages, bonuses, benefits and stock-based compensation for research and development and engineering employees, allocated facility costs, laboratory supplies, product development materials, consulting fees and related costs, and testing costs for new product launches and enhancements to existing products. We have made substantial investments in research and development since our inception. Our research and development efforts have focused primarily on the tasks required to enhance our technologies and to support development and commercialization of new and existing products. We plan to continue to invest in research and development activities to stay at the forefront of patient preference in oxygen therapy devices. We expect research and development expense to increase in absolute dollars in future periods as we continue to invest in our engineering and technology teams to support our new and enhanced product research and development efforts and manufacturing improvements. We expect increased research and development costs associated with the New Aera acquisition and the incorporation of the TAV technology into our Inogen One portable oxygen concentrators.

Sales and marketing

Our sales and marketing expense primarily supports our direct-to-consumer marketing and rental strategy and consists mainly of personnel-related expenses, including wages, bonuses, commissions, benefits, and stock-based compensation for sales, marketing, customer service and clinical service employees. It also includes expenses for media and advertising, printing, informational kits, dues and fees, including credit card fees, recruiting, training, sales promotional and marketing activities, travel and entertainment expenses as well as allocated facilities costs. Sales and marketing expense increased throughout 2018, primarily due to an increase in marketing and sales force expenses and increased in the three and six months ended June 30, 2019, primarily due to an increase in marketing expenses, partially offset by reduced personnel-related expenses. For example, we have seen the cost per generated lead trend higher than historical averages. In addition, many of the sales representatives we hired in 2018 were unable to meet sales targets and were thus transitioned out. Going forward, we have restarted our sales capacity expansion efforts, but we plan to hire additional sales representatives at a more controlled pace across all of our facilities to expand sales capacity, and we expect sales representative headcount to be down meaningfully at year end 2019 compared to year end 2018. We still expect a further increase in sales and marketing expense in future periods as we continue to invest in our business, including expanding our sales and sales support team, increasing media spend to drive consumer awareness, and increasing patient support costs as our patient and customer base increases. We also opened a new facility in Cleveland, Ohio in the third quarter of 2017 primarily for sales and customer service personnel. We also established a physical presence in Europe by acquiring MedSupport Systems B.V. on May 4, 2017. This acquisition has increased sales and marketing costs but has also improved customer service and repair services in the European markets. We expect increased sales and marketing costs associated with the New Aera acquisition.

General and administrative

Our general and administrative expense consists primarily of personnel-related expenses, including wages, bonuses, benefits, and stock-based compensation for employees in our compliance, finance, medical billing, rental intake, human resources, and information technology departments as well as facilities costs, sales bad debt expense, and board of directors' expenses, including stock-based compensation. In addition, general and administrative expense includes professional services, such as legal, patent registration and defense costs, insurance, consulting and accounting services, including audit and tax services, and travel and entertainment expenses.

We expect general and administrative expense to increase in future periods as the number of administrative personnel grows and we continue to introduce new products, broaden our customer base and grow our business. We expect general and administrative expense to increase in absolute dollars as we continue to invest in corporate infrastructure to support our growth including personnel-related expenses, professional services fees and compliance costs associated with operating as a public company as well as acquisition-related costs. Those costs include increases in our accounting, human resources, and IT personnel, as well as increases in additional consulting, legal and accounting fees, facilities costs, insurance costs, and board members' compensation. We expect increased general and administrative costs associated with the New Aera acquisition, including intangible amortization costs.

Other income (expense), net

Our other income (expense), net consists primarily of interest income earned on cash equivalents and marketable securities as well as foreign currency gains and (losses).

Income taxes

We account for income taxes in accordance with ASC 740—*Income Taxes*. Under ASC 740, income taxes are recognized for the amount of taxes payable or refundable for the current period and deferred tax liabilities and assets are recognized for the future tax consequences of transactions that have been recognized in our consolidated financial statements or tax returns. A valuation allowance is provided when it is more likely than not that some portion, or all, of the deferred tax asset will not be realized.

We account for uncertainties in income tax in accordance with ASC 740-10—*Accounting for Uncertainty in Income Taxes*. ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This accounting standard also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The accounting for stock-based compensation will increase or decrease our effective tax rate based upon the difference between our stock-based compensation expense and the deductions taken on our U.S. tax return, which depends upon the stock price at the time of employee option exercise or award vesting. We recognize excess tax benefits or deficiencies on a discrete basis and we anticipate our effective tax rate will vary from quarter-to-quarter depending on our stock price in each period.

Results of operations

Comparison of three months ended June 30, 2019 and June 30, 2018

Revenue

	Three months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	**2019**	**2018**	**$**	**%**	**2019**	**2018**
Sales revenue	$ 95,863	$ 91,987	$ 3,876	4.2%	94.9%	94.6%
Rental revenue	5,200	5,251	(51)	-1.0%	5.1%	5.4%
Total revenue	$ 101,063	$ 97,238	$ 3,825	3.9%	100.0%	100.0%

Sales revenue increased $3.9 million for the three months ended June 30, 2019 from the three months ended June 30, 2018, or an increase of 4.2% over the comparable period. The increase was primarily attributable to an 1,800-unit increase in the number of oxygen systems sold. We sold approximately 56,500 oxygen systems during the three months ended June 30, 2019 compared to approximately 54,700 oxygen systems sold during the three months ended June 30, 2018, or an increase of 3.3%. The increase in the number of systems sold resulted mainly from an increase in direct-to-consumer sales in the United States, primarily due to increased sales representative productivity and increased marketing expenditures, partially offset by a decline in sales representative headcount, and an increase in international business-to-business sales, primarily due to purchases from our European partners. These increases were partially offset by a decline in domestic business-to-business sales resulting from reduced orders from a national provider who is a customer of our private label partner and reduced sales to our internet reseller customers. The national provider who is a customer of our private label partner accounted for revenue of $0.7 million in the second quarter of 2019, down from $8.3 million in the second quarter of 2018.

Rental revenue decreased $0.1 million for the three months ended June 30, 2019 from the three months ended June 30, 2018, or a decrease of 1.0% from the comparable period. The decrease in rental revenue was primarily related to a 9.1% decline in rental patients on service from the comparative period, partially offset by lower rental revenue adjustments.

(amounts in thousands)	Three months ended June 30,		Change 2019 vs. 2018		% of Revenue	
Revenue by region and category	**2019**	**2018**	**$**	**%**	**2019**	**2018**
Business-to-business domestic sales	$ 29,653	$ 32,943	$ (3,290)	-10.0%	29.4%	33.9%
Business-to-business international sales	22,564	20,759	1,805	8.7%	22.3%	21.3%
Direct-to-consumer domestic sales	43,646	38,285	5,361	14.0%	43.2%	39.4%
Direct-to-consumer domestic rentals	5,200	5,251	(51)	-1.0%	5.1%	5.4%
Total revenue	$ 101,063	$ 97,238	$ 3,825	3.9%	100.0%	100.0%

Domestic direct-to-consumer sales increased 14.0% and domestic business-to-business sales decreased 10.0% for the three months ended June 30, 2019 compared to the three months ended June 30, 2018. The increase in direct-to-consumer sales was primarily due to increased productivity of inside sales representatives, increased marketing expenditures, and expansion of marketing strategies, partially offset by a decline in sales representative headcount. The decrease in domestic business-to-business sales was primarily the result of decreased demand from our private label partner due to reduced orders from the national provider referenced above and reduced demand from internet reseller customers, partially offset by increased demand from traditional HME providers.

Business-to-business international sales increased 8.7% for the three months ended June 30, 2019 compared to the three months ended June 30, 2018, primarily due to increased sales to our partners in Europe and partially offset by unfavorable currency exchange rates. We sell our products in 46 countries outside of the United States, and we plan to continue to expand our presence in other countries as the opportunities present themselves. Of our international sales revenue in the three months ended June 30, 2019, 88.2% was sold in Europe versus 88.3% in the comparative period in 2018.

Cost of revenue and gross profit

(amounts in thousands)	Three months ended June 30,		Change 2019 vs. 2018		% of Revenue	
	2019	**2018**	**$**	**%**	**2019**	**2018**
Cost of sales revenue	$ 47,230	$ 44,968	$ 2,262	5.0%	46.7%	46.3%
Cost of rental revenue	3,618	3,800	(182)	-4.8%	3.6%	3.9%
Total cost of revenue	$ 50,848	$ 48,768	$ 2,080	4.3%	50.3%	50.2%
Gross profit - sales revenue	$ 48,633	$ 47,019	$ 1,614	3.4%	48.1%	48.3%
Gross profit - rental revenue	1,582	1,451	131	9.0%	1.6%	1.5%
Total gross profit	$ 50,215	$ 48,470	$ 1,745	3.6%	49.7%	49.8%
Gross margin percentage - sales revenue	50.7%	51.1%				
Gross margin percentage- rental revenue	30.4%	27.6%				
Total gross margin percentage	49.7%	49.8%				

We manufacture our subassemblies and/or products in ourRichardson, Texas and Goleta, California facilities. We also began production of our Inogen One G3 concentrators in the fourth quarter of 2017 using a contract manufacturer, Foxconn, located in the Czech Republic to improve our ability to service our European customers. Our manufacturing process includes final assembly, testing, and packaging to quality and customer specifications. Cost of sales revenue increased $2.3 million for the three months ended June 30, 2019 from the three months ended June 30, 2018, or an increase of 5.0% over the comparable period. The increase in cost of sales revenue was primarily attributable to an increase in the number of systems sold and increased mix of direct-to consumer sales which typically includes systems with a higher amount of accessories orders versus business-to-business sales, partially offset by reduced bill of material costs for our products associated withdesign changes, better sourcing and price discounts resulting from increased volumes in spite of the Inogen One G5 launch and higher tariff costs. We expect cost of sales revenue as a percentage of sales revenue in future periods to fluctuate based on changes in the sales channel mix, product mix, average selling prices and cost per unit.

Cost of rental revenue decreased $0.2 million for the three months ended June 30, 2019 from the three months ended June 30, 2018, or a decrease of 4.8% from the comparable period. The decrease in cost of rental revenue was primarily attributable to a decrease in rental asset depreciation expense, partially offset by increased servicing costs. Cost of rental revenue included $1.6 million of rental asset depreciation for the three months ended June 30, 2019 and $2.0 million for the three months ended June 30, 2018.

Gross margin percentage is defined as revenue less cost of revenue divided by revenue. Sales revenue gross margin percentage decreased to 50.7% for the three months ended June 30, 2019 from 51.1% for the three months ended June 30, 2018. The decrease in sales revenue gross margin percentage was primarily related to a decrease in average selling prices, partially offset by increased sales mix toward higher margin domestic direct-to-consumer sales and lower cost per unit in spite of the Inogen G5 launch and increased tariffs. Total worldwide business-to-business sales revenue accounted for 54.5% of total sales revenue in the second quarter of 2019 versus 58.4% in the second quarter of 2018. We expect sales gross margin to fluctuate over time based on changes in the sales channel mix, product mix, average selling prices and cost per unit.

Rental revenue gross margin percentage increased to 30.4% for the three months ended June 30, 2019 from 27.6% for the three months ended June 30, 2018, primarily due to higher rental revenue per patient on service and lower depreciation costs, partially offset by increased servicing costs.

Research and development expense

	Three months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	**2019**	**2018**	**$**	**%**	**2019**	**2018**
Research and development expense	$ 1,468	$ 1,775	$ (307)	-17.3%	1.5%	1.8%

Research and development expense decreased $0.3 million for the three months ended June 30, 2019 from the three months ended June 30, 2018, or a decrease of 17.3% from the comparable period, primarily due to a $0.2 million decrease in personnel-related expenses.

Sales and marketing expense

	Three months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	**2019**	**2018**	**$**	**%**	**2019**	**2018**
Sales and marketing expense	$ 27,758	$ 22,999	$ 4,759	20.7%	27.5%	23.7%

Sales and marketing expense increased $4.8 million for the three months ended June 30, 2019 from the three months ended June 30, 2018, or an increase of 20.7% over the comparable period. The increase was primarily attributable to an increase of $5.3 million in media spending, partially offset by a decrease of $1.0 million in sales and marketing personnel-related expenses (which included $0.8 million in bonus expense and $0.3 million in stock compensation expense). In the three months ended June 30, 2019, we spent $11.6 million in media and advertising costs versus $6.3 million in the comparative period in 2018.

General and administrative expense

(amounts in thousands)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change 2019 vs. 2018 $	Change 2019 vs. 2018 %	% of Revenue 2019	% of Revenue 2018
General and administrative expense	$ 8,844	$ 9,675	$ (831)	-8.6%	8.7%	9.9%

General and administrative expense decreased $0.8 million for the three months ended June 30, 2019 from the three months ended June 30, 2018, or a decrease of 8.6% from the comparable period. The decrease was primarily attributable to $1.4 million in personnel-related expenses (which included $1.0 million in stock compensation expense, $0.8 million in bonus expense, partially offset by $0.4 million in higher wages, benefits and payroll tax expense) and $0.3 million in bad debt expense. These were partially offset by $0.3 million in acquisition-related expense for the New Aera transaction.

Bad debt expense, expressed as a percentage of total revenue, was 0.0% and 0.3% in the three months ended June 30, 2019 and June 30, 2018, respectively, primarily due to the adoption of ASU No. 2018-19.

Other income (expense), net

(amounts in thousands)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change 2019 vs. 2018 $	Change 2019 vs. 2018 %	% of Revenue 2019	% of Revenue 2018
Interest income	$ 1,394	$ 673	$ 721	107.1%	1.4%	0.7%
Other income (expense)	145	(1,048)	1,193	113.8%	0.1%	-1.1%
Total other income (expense), net	$ 1,539	$ (375)	$ 1,914	510.4%	1.5%	-0.4%

Total other income (expense), net increased $1.9 million for the three months ended June 30, 2019 from the three months ended June 30, 2018, or an increase of 510.4% over the comparable period. The increase was primarily attributable to $1.2 million in other income (expense) related to net foreign currency gains arising from increased transactions in Euros at a lower U.S. dollar exchange rate to the Euro compared to net foreign currency losses recorded in the comparable period, and an increase of $0.7 million in interest income on cash equivalents and marketable securities versus the amount recorded in the comparable period.

Income tax expense (benefit)

(amounts in thousands)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change 2019 vs. 2018 $	Change 2019 vs. 2018 %	% of Revenue 2019	% of Revenue 2018
Income tax expense (benefit)	$ 3,524	$ (964)	$ 4,488	465.6%	3.4%	-1.0%
Effective income tax rate	*25.8%*	*-7.1%*				

Income tax expense increased $4.5 million for the three months ended June 30, 2019 from the three months ended June 30, 2018, primarily attributable to lower excess tax benefits of $4.0 million recognized from stock-based compensation, partially offset by a $0.4 million increase in the income tax expense.

Our effective tax rate in the second quarter of 2019 increased compared to the second quarter of 2018, primarily due to the decrease in excess tax benefits recognized from stock-based compensation, the changes in income before income tax expense (benefit) and lower foreign tax credits. In the second quarter of 2019, excess tax deficits recognized from stock-based compensation increased our income tax expense by $0.2 million and our effective tax rate by 1.4%, as compared to the tax rate without such benefits. For comparison, in the second quarter of 2018, excess tax benefits recognized from stock-based compensation decreased our income tax expense by $3.9 million and our effective tax rate by 28.3%, as compared to the tax rate without such benefits.

Net income

(amounts in thousands)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change 2019 vs. 2018 $	Change 2019 vs. 2018 %	% of Revenue 2019	% of Revenue 2018
Net income	$ 10,160	$ 14,610	$ (4,450)	-30.5%	10.1%	15.0%

Net income decreased $4.5 million for the three months ended June 30, 2019 from the three months ended June 30, 2018, or a decrease of 30.5% from the comparable period. The decrease in net income was primarily related to an increase in operating expenses and a higher effective tax rate.

Comparison of six months ended June 30, 2019 and June 30, 2018

Revenue

	Six months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	**2019**	**2018**	**$**	**%**	**2019**	**2018**
Sales revenue	$ 180,681	$ 165,571	$ 15,110	9.1%	94.5%	93.9%
Rental revenue	10,584	10,718	(134)	-1.3%	5.5%	6.1%
Total revenue	$ 191,265	$ 176,289	$ 14,976	8.5%	100.0%	100.0%

Sales revenue increased $15.1 million for the six months ended June 30, 2019 from the six months ended June 30, 2018, or an increase of 9.1% over the comparable period. The increase was primarily attributable to a 6,800-unit increase in the number of oxygen systems sold. We sold approximately 106,900 oxygen systems during the six months ended June 30, 2019 compared to approximately 100,100 oxygen systems sold during the six months ended June 30, 2018, or an increase of 6.8%. The increase in the number of systems sold resulted mainly from an increase in direct-to-consumer sales in the United States, primarily due to increased sales representative productivity and increased marketing expenditures, partially offset by a decline in sales representative headcount, and an increase in international business-to-business sales, primarily from our European partners. These increases were partially offset by a decline in domestic business-to-business sales, primarily due to reduced orders from a national provider who is a customer of our private label partner and reduced sales to our internet reseller customers. The national provider who is a customer of our private label partner accounted for revenue of $1.4 million in the first six months of 2019, down from $17.6 million in the first six months of 2018.

Rental revenue decreased $0.1 million for the six months ended June 30, 2019 from the six months ended June 30, 2018, or a decrease of 1.3% from the comparable period. The decrease in rental revenue was primarily related to a decline in rental patients on service, which decreased 9.1% from the comparative period, partially offset by an increase in rental revenue per patient mainly due to lower rental revenue adjustments.

	Six months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)						
Revenue by region and category	**2019**	**2018**	**$**	**%**	**2019**	**2018**
Business-to-business domestic sales	$ 55,714	$ 60,959	$ (5,245)	-8.6%	29.1%	34.5%
Business-to-business international sales	42,367	37,665	4,702	12.5%	22.2%	21.4%
Direct-to-consumer domestic sales	82,600	66,947	15,653	23.4%	43.2%	38.0%
Direct-to-consumer domestic rentals	10,584	10,718	(134)	-1.3%	5.5%	6.1%
Total revenue	$ 191,265	$ 176,289	$ 14,976	8.5%	100.0%	100.0%

Domestic direct-to-consumer sales increased 23.4% and domestic business-to-business sales decreased 8.6% for the six months ended June 30, 2019 compared to the six months ended June 30, 2018. The increase in direct-to-consumer sales was primarily due to increased productivity of inside sales representatives, increased marketing expenditures, and expansion of marketing strategies, partially offset by a decline in sales representative headcount. The decrease in domestic business-to-business sales was primarily the result of decreased demand from our private label partner due to reduced orders from the national provider referenced above and reduced demand from internet reseller customers, partially offset by increased demand from traditional HME providers.

Business-to-business international sales increased 12.5% for the six months ended June 30, 2019 compared to the six months ended June 30, 2018, primarily due to increased sales to our partners in Europe, partially offset by unfavorable currency exchange rates. We sell our products in 46 countries outside of the United States, and we plan to continue to expand our presence in other countries as the opportunities present themselves. Of our international sales revenue in the six months ended June 30, 2019, 87.4% was sold in Europe versus 88.8% in the comparative period in 2018, primarily because of the increase in sales in Canada, South America, and Australia.

Cost of revenue and gross profit

	Six months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	2019	2018	$	%	2019	2018
Cost of sales revenue	$ 89,297	$ 81,916	$ 7,381	9.0%	46.7%	46.5%
Cost of rental revenue	7,344	8,176	(832)	-10.2%	3.8%	4.6%
Total cost of revenue	$ 96,641	$ 90,092	$ 6,549	7.3%	50.5%	51.1%
Gross profit - sales revenue	$ 91,384	$ 83,655	$ 7,729	9.2%	47.8%	47.5%
Gross profit - rental revenue	3,240	2,542	698	27.5%	1.7%	1.4%
Total gross profit	$ 94,624	$ 86,197	$ 8,427	9.8%	49.5%	48.9%
Gross margin percentage - sales revenue	50.6%	50.5%				
Gross margin percentage- rental revenue	30.6%	23.7%				
Total gross margin percentage	49.5%	48.9%				

We manufacture our subassemblies and/or products in our Richardson, Texas and Goleta, California facilities. We also began production of our Inogen One G3 concentrators in the fourth quarter of 2017 using a contract manufacturer, Foxconn, located in the Czech Republic to improve our ability to service our European customers. Our manufacturing process includes final assembly, testing, and packaging to quality and customer specifications. Cost of sales revenue increased $7.4 million for the six months ended June 30, 2019 from the six months ended June 30, 2018, or an increase of 9.0% over the comparable period. The increase in cost of sales revenue was primarily attributable to an increase in the number of systems sold and increased mix toward direct-to-consumer sales which typically includes systems with a higher amount of accessories orders versus business-to-business sales, partially offset by reduced bill of material costs for our products associated with design changes, better sourcing and price discounts resulting from increased volumes, in spite of the Inogen One G5 launch and higher tariff costs. We expect cost of sales revenue as a percentage of sales revenue in future periods to fluctuate based on changes in the sales channel mix, product mix, and average selling prices and cost per unit.

Cost of rental revenue decreased $0.8 million for the six months ended June 30, 2019 from the six months ended June 30, 2018, or a decrease of 10.2% from the comparable period. The decrease in cost of rental revenue was primarily attributable to a decrease in total patients on service and rental asset depreciation expense, partially offset by increased servicing costs. Cost of rental revenue included $3.3 million of rental asset depreciation for the six months ended June 30, 2019 and $4.1 million for the six months ended June 30, 2018.

Gross margin percentage is defined as revenue less cost of revenue divided by revenue. Sales revenue gross margin percentage increased slightly to 50.6% for the six months ended June 30, 2019 from 50.5% for the six months ended June 30, 2018. The increase in sales gross margin percentage was primarily related to an increase in sales mix toward higher margin domestic direct-to-consumer sales and lower cost per unit, partially offset by lower average selling prices. Total worldwide business-to-business sales revenue accounted for 54.3% of total sales revenue in the first six months of 2019 versus 59.6% in the first six months of 2018. We expect sales gross margin to fluctuate over time based on changes in the sales channel mix, product mix, average selling prices and cost per unit.

Rental revenue gross margin percentage increased to 30.6% for the six months ended June 30, 2019 from 23.7% for the six months ended June 30, 2018, primarily due to higher rental revenue per patient on service and lower depreciation costs, partially offset by increased servicing costs.

Research and development expense

	Six months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	2019	2018	$	%	2019	2018
Research and development expense	$ 3,137	$ 3,191	$ (54)	-1.7%	1.6%	1.8%

Research and development expense decreased $0.1 million for the six months ended June 30, 2019 from the six months ended June 30, 2018, or a decrease of 1.7% from the comparable period, primarily due to a $0.4 million decrease in personnel-related expenses (which included $0.3 million in bonus expense and $0.1 million in stock compensation expense) and an increase of $0.3 million in product development expenses for engineering projects.

Sales and marketing expense

	Six months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	2019	2018	$	%	2019	2018
Sales and marketing expense	$ 55,959	$ 41,037	$ 14,922	36.4%	29.3%	23.3%

Sales and marketing expense increased $14.9 million for the six months ended June 30, 2019 from the six months ended June 30, 2018, or an increase of 36.4% over the comparable period. The increase was primarily attributable to increases of $10.7 million in media spending, $2.9 million of personnel-related expenses (which included increases of $2.1 million in wages, benefits and payroll tax expense and $1.9 million in commissions expense, partially offset by a decrease of $1.0 million in bonus expense), $0.4 million in dues, fees and license costs and $0.3 million in allocated facilities costs. In the six months ended June 30, 2019, we spent $21.8 million in media and advertising costs versus $11.1 million in the comparative period in 2018.

General and administrative expense

	Six months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	2019	2018	$	%	2019	2018
General and administrative expense	$ 18,525	$ 19,248	$ (723)	-3.8%	9.7%	10.9%

General and administrative expense decreased $0.7 million for the six months ended June 30, 2019 from the six months ended June 30, 2018, or a decrease of 3.8% from the comparable period. The decrease was primarily attributable to $1.2 million in lower personnel-related expenses (which included decreases of $1.0 million in bonus expense and $1.0 million in stock compensation expense, partially offset by an increase of $0.8 million in wages, benefits and payroll tax expense) and $1.0 million in lower bad debt expense. These decreases were partially offset by $0.4 million in lower net proceeds received from sale of assets as well as increases of $0.3 million of acquisition-related expense for the New Aera transaction, $0.3 million in dues, fees and license costs and $0.2 million in depreciation expense.

Bad debt expense, expressed as a percentage of total revenue, was 0.0% and 0.6% in the six months ended June 30, 2019 and June 30, 2018, respectively, primarily due to the adoption of ASU 2018-19.

Other income

	Six months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	2019	2018	$	%	2019	2018
Interest income	2,728	1,216	1,512	124.3%	1.4%	0.7%
Other income (expense)	25	(604)	629	104.1%	0.0%	-0.3%
Total other income	$ 2,753	$ 612	$ 2,141	349.8%	1.4%	0.4%

Total other income increased $2.1 million for the six months ended June 30, 2019 from the six months ended June 30, 2018, or an increase of 349.8% over the comparable period. The increase was primarily attributable to $1.5 million in interest income on cash equivalents and marketable securities and $0.6 million in other income (expense) related to net foreign currency gains arising from increased transactions in Euros at a lower U.S. dollar exchange rate to the Euro compared to net foreign currency losses recorded in the comparable period.

Income tax expense (benefit)

	Six months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	2019	2018	$	%	2019	2018
Income tax expense (benefit)	$ 4,294	$ (2,035)	$ 6,329	311.0%	2.2%	-1.2%
Effective income tax rate	*21.7%*	*-8.7%*				

Income tax expense increased $6.3 million for the six months ended June 30, 2019 from the six months ended June 30, 2018, primarily attributable to lower excess tax benefits of $6.7 million recognized from stock-based compensation, partially offset by a $0.3

million decrease in the income tax provision expense, primarily resulting from a 15.3% decrease in income before income tax expense (benefit)

Our effective tax rate in the first six months of 2019 increased compared to the first six months of 2018, primarily due to the decrease in excess tax benefits recognized from stock-based compensation, the changes in income before income tax expense (benefit) and lower foreign tax credits. In the first six months of 2019, excess tax benefits recognized from stock-based compensation decreased our income tax expense by $0.4 million and our effective tax rate by 2.3%, as compared to the tax rate without such benefits. For comparison, in the first six months of 2018, excess tax benefits recognized from stock-based compensation decreased our income tax expense by $7.1 million and our effective tax rate by 30.4%, as compared to the tax rate without such benefits.

Net income

	Six months ended June 30,		Change 2019 vs. 2018		% of Revenue	
(amounts in thousands)	2019	2018	$	%	2019	2018
Net income	$ 15,462	$ 25,368	$ (9,906)	-39.0%	8.1%	14.4%

Net income decreased $9.9 million for the six months ended June 30, 2019 from the six months ended June 30, 2018, or a decrease of 39.0% from the comparable period. The decrease in net income was primarily related to an increase in operating expenses and a higher effective tax rate.

Contractual obligations

We obtain individual components for our products from a wide variety of individual suppliers. Consistent with industry practice, we acquire components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Where appropriate, the purchases are applied to inventory component prepayments that are outstanding with the respective supplier. As of June 30, 2019, we had purchase obligations with outside vendors and suppliers of approximately $61.7 million of which the timing varies depending on demand, current supply on hand and other factors. The obligations normally do not extend beyond twelve-month time frames.

On June 19, 2019, we entered into a commercial and industrial building lease for approximately 50,000 rentable square feet located in Goleta, California (the "New Headquarters"). The New Headquarters will replace the lease for our existing Goleta headquarters, which expires on October 31, 2020. The term of the New Headquarters lease commences on November 1, 2020, at which time we expect to move into the New Headquarters and expires on December 31, 2030. The minimum monthly base rent under this lease will initially be approximately $94,660 per month. Base rent will increase annually by the lesser of the change, if any, in the Consumer Price Index of the Bureau of Labor Statistics of the U.S. Department of Labor or three and one-half percent (3.5%) at each annual adjustment date thereafter. For additional information regarding our total lease obligations, refer to Note 5 – Leases in the condensed notes to our consolidated financial statements included in this report.

Except as indicated above, there have been no other material changes, outside of the ordinary course of business, in our outstanding contractual obligations from those disclosed within "Management's Discussion and Analysis of Financial Condition and Results of Operations" section contained in our Annual Report on Form 10-K filed with the SEC on February 26, 2019.

Off-balance sheet arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or for any other contractually narrow or limited purpose. However, from time-to-time, we enter into certain types of contracts that contingently require us to indemnify parties against third-party claims including certain real estate leases, supply purchase agreements, and directors and officers. The terms of such obligations vary by contract and in most instances a maximum dollar amount is not explicitly stated therein. Generally, amounts under these contracts cannot be reasonably estimated until a specific claim is asserted thus no liabilities have been recorded for these obligations on our balance sheets for any of the periods presented.

Liquidity and capital resources

As of June 30, 2019, we had cash and cash equivalents of $213.9 million, which consisted of highly-liquid investments with a maturity of three months or less. In addition, we held marketable securities of $42.2 million in available-for-sale corporate bonds and U.S. Treasury securities, which had maturities greater than three months. Since inception, we have received net proceeds of $91.7

million from the issuance of redeemable convertible preferred stock and convertible preferred stock and $52.5 million ($49.7 million net proceeds) in connection with the sale of common stock in our initial public offering. Since 2013, we have received $48.6 million from proceeds related to stock option exercises andour employee stock purchase plan. For the six months ended June 30, 2019 and June 30, 2018, we received $3.4 million and $7.5 million, respectively, in proceeds related to these stock programs.

Our principal uses of cash for liquidity and capital resources in the six months ended June 30, 2019 consisted of capital expenditures of $3.5 million including additional rental equipment, intangible assets, and other property, plant and equipment, partially offset by net maturities of marketable securities of $1.5 million.

We believe that our current cash, cash equivalents, marketable securities, and the cash to be generated from expected product sales and rentals will be sufficient to meet our projected operating and investing requirements for at least the next twelve months. However, our liquidity assumptions may prove to be incorrect, and we could utilize our available financial resources sooner than we currently expect. Our future funding requirements will depend on many factors, including market acceptance of our products; the cost of our research and development activities; payments from customers; the cost, timing, and outcome of litigation or disputes, our products, employee relations, cyber security incidents, or otherwise; the cost and timing of acquisitions; the cost and timing of regulatory clearances or approvals; the cost and timing of establishing additional sales, marketing, and distribution capabilities; and the effect of competing technological and market developments. In the future, we may acquire businesses or technologies from third parties, and we may decide to raise additional capital through debt or equity financing to the extent we believe this is necessary to successfully complete these acquisitions. Our future capital requirements will also depend on many additional factors, including those set forth in the section of this Quarterly Report on Form 10-Q entitled “Risk Factors.”

If we require additional funds in the future, we may not be able to obtain such funds on acceptable terms, or at all. In the future, we may also attempt to raise additional capital through the sale of equity securities or through equity-linked or debt financing arrangements. If we raise additional funds by issuing equity or equity-linked securities, the ownership of our existing stockholders will be diluted. If we raise additional financing by the incurrence of indebtedness, we will be subject to increased fixed payment obligations and could also be subject to restrictive covenants, such as limitations on our ability to incur additional debt, and other operating restrictions that could adversely impact our ability to conduct our business. Any future indebtedness we incur may result in terms that could be unfavorable to equity investors. There can be no assurances that we will be able to raise additional capital, which would adversely affect our ability to achieve our business objectives. In addition, if our operating performance during the next twelve months is below our expectations, our liquidity and ability to operate our business could be adversely affected.

The following tables show a summary of our cash flows and working capital for the periods and as of the dates indicated:

(amounts in thousands)	**Six months ended June 30,**		**Change 2019 vs. 2018**	
Summary of consolidated cash flows	**2019**	**2018**	**$**	**%**
Cash provided by operating activities	$ 16,603	$ 33,263	$ (16,660)	-50.1%
Cash used in investing activities	(1,832)	(17,446)	15,614	89.5%
Cash provided by financing activities	2,618	7,203	(4,585)	-63.7%
Effect of exchange rates on cash	(76)	371	(447)	-120.5%
Net increase in cash and cash equivalents	$ 17,313	$ 23,391	$ (6,078)	-26.0%

(amounts in thousands) **Working capital**	June 30, 2019	December 31, 2018
Cash and cash equivalents	$ 213,947	$ 196,634
Marketable securities	42,202	43,715
Accounts receivable, net	46,721	37,041
Inventories, net	24,485	27,071
Deferred cost of revenue	352	359
Income tax receivable	2,750	2,655
Prepaid expenses and other current assets	10,269	7,108
Total current assets	340,726	314,583
Accounts payable and accrued expenses	27,325	26,786
Accrued payroll	6,969	11,407
Warranty reserve - current	4,036	3,549
Operating lease liability - current	2,006	—
Deferred revenue - current	5,616	4,451
Income tax payable	410	392
Total current liabilities	46,362	46,585
Net working capital	$ 294,364	$ 267,998

Operating activities

We derive operating cash flows from cash collected from the sales and rental of our products and services. These cash flows received are partially offset by our use of cash for operating expenses to support the growth of our business. Net income in most periods has increased associated with increased sales, improving product mix and lower costs of revenues.

Net cash provided by operating activities for the six months ended June 30, 2019 consisted primarily of our net income of $15.5 million as well as non-cash expense items such as provision for sales returns and doubtful accounts of $8.9 million, depreciation of equipment and leasehold improvements and amortization of our intangibles of $5.6 million, stock-based compensation expense of $5.4 million, an increase in deferred tax assets of $4.1 million, provision for rental revenue adjustments of $1.2 million, and provision for inventory obsolescence and other inventory losses of $0.4 million. The net changes in operating assets and liabilities resulted in a net use of cash of $24.6 million.

Net cash provided by operating activities for the six months ended June 30, 2018 consisted primarily of our net income of $25.4 million and non-cash expense items such as provision for sales returns and doubtful accounts of $9.9 million, stock-based compensation expense of $6.6 million, depreciation of equipment and leasehold improvements and amortization of our intangibles of $5.8 million, provision for rental revenue adjustments of $1.4 million, and loss on disposal of rental equipment and other fixed assets of $0.5 million. These were partially offset by an increase in deferred tax assets of $2.1 million and gain on former rental assets of $0.4 million. The net changes in operating assets and liabilities resulted in a net use of cash of $14.1 million.

Investing activities

Net cash used in investing activities for each of the periods presented included cash used in the production and purchase of rental assets, manufacturing tooling, and computer equipment and software to support our expanding business as well as net (purchases) maturities of marketable securities.

For the six months ended June 30, 2019, we invested $38.6 million in corporate bonds and U.S. Treasury securities with maturities greater than three months that were classified as marketable securities, partially offset by $40.2 million in maturities of marketable securities. In addition, we invested $3.4 million in the production and purchase of rental assets and other property, equipment, and leasehold improvements.

For the six months ended June 30, 2018, we had $39.3 million of purchases that we invested in certificates of deposits, corporate bonds, agency mortgage-backed securities, and U.S. Treasury securities with maturities greater than three months that were classified as marketable securities, partially offset by $28.2 million in maturities of available-for-sale investments. In addition, we invested $7.0 million in the production and purchase of rental assets and other property, equipment, and leasehold improvements, partially offset from gross proceeds received from the sale of former rental assets of $0.6 million.

We expect to continue investing in property, equipment and leasehold improvements as we expand our operations. Our business is inherently capital intensive. For example, we expend significant manufacturing and production expense in connection with the development and production of our oxygen concentrator products and, in connection with our rental business, we incur expense in the deployment of rental equipment to our patients. Investments will continue to be required in order to grow our sales and rental revenue and continue to supply and replace rental equipment to our rental patients on service.

Financing activities

Historically, we have funded our operations through our sales and rental revenue, the issuance of preferred and common stock, and the incurrence of indebtedness.

For the six months ended June 30, 2019, net cash provided by financing activities consisted of $3.4 million from the proceeds received from stock options that were exercised and purchases under our employee stock purchase program, partially offset by the payment of employment taxes related to the vesting of restricted stock awards and restricted stock units of $0.8 million.

For the six months ended June 30, 2018, net cash provided by financing activities consisted of $7.5 million from the proceeds received from stock options that were exercised and purchases under our employee stock purchase program, partially offset by the payment of employment taxes related to the vesting of restricted stock awards and restricted stock units of $0.3 million.

Working capital

Working capital at any specific point in time is subject to many variables including seasonality, inventory management, and the timing of cash receipts and payments.

Current assets increased $26.1 million during the six months ended June 30, 2019 from December 31, 2018, primarily due to increases of $15.8 million in cash, cash equivalents and marketable securities, $9.7 million in net accounts receivable and $3.2 million in prepaid expenses and other current assets, partially offset by a decrease in net inventories of $2.6 million.

Gross accounts receivable increased $9.9 million during the six months ended June 30, 2019 from December 31, 2018, primarily due to an increase in gross business-to-business accounts receivable and other receivables balance of $10.2 million, partially offset by a decrease in gross rental accounts receivable balance of $0.3 million. Allowances on accounts receivable slightly increased during the six months ended June 30, 2019 from December 31, 2018, primarily due to an increase of $0.4 million in the allowance for sales returns, partially offset by a decrease of $0.2 million in the allowance for doubtful accounts from the comparative consolidated balance sheet date.

Allowances on accounts receivable vary based on credit quality, age, and accounts receivable source. Rental revenue has higher allowances for adjustments and doubtful accounts on accounts receivable versus sales revenue due to the nature of the collectability of these balances.

Current liabilities decreased by $0.2 million during the six months ended June 30, 2019 from December 31, 2018, primarily due to a decrease of $4.4 million in accrued payroll, partially offset by increases of $2.0 million in the operating lease liability, $1.2 million in deferred revenue, $0.5 million in the warranty reserve and $0.5 million in accounts payable and accrued expenses.

Sources of funds

Our cash provided by operating activities in the six months ended June 30, 2019 was $16.6 million compared to $33.3 million in the six months ended June 30, 2018. As of June 30, 2019, we had cash and cash equivalents of $213.9 million.

Use of funds

Our principal uses of cash are funding our new rental asset deployments and other capital purchases, operations, and other working capital requirements. Over the past several years, our revenue has increased significantly from year-to-year and, as a result, our cash flows from customer collections have increased as have our profits. As a result, our annual cash provided by operating activities has generally increased over time and has been a significant source of capital to the business, which we expect to continue in the future.

We may need to raise additional funds to support our investing operations, and such funding may not be available to us on acceptable terms, or at all. If we are unable to raise additional funds when needed, our operations and ability to execute our business strategy could be adversely affected. We may seek to raise additional funds through equity, equity-linked or debt financings. If we raise additional funds through the incurrence of indebtedness, such indebtedness would have rights that are senior to holders of our equity securities and could contain covenants that restrict our operations. Any additional equity financing may be dilutive to our stockholders.

Non-GAAP financial measures

EBITDA and Adjusted EBITDA are financial measures that are not calculated in accordance with U.S. GAAP. We define EBITDA as net income excluding interest income, interest expense, taxes and depreciation and amortization. Adjusted EBITDA also excludes stock-based compensation. Below, we have provided a reconciliation of EBITDA and Adjusted EBITDA to our net income, the most directly comparable financial measure calculated and presented in accordance with U.S. GAAP. EBITDA and Adjusted EBITDA should not be considered alternatives to net income or any other measure of financial performance calculated and presented in accordance with U.S. GAAP. Our EBITDA and Adjusted EBITDA may not be comparable to similarly titled measures of other organizations because other organizations may not calculate EBITDA and Adjusted EBITDA in the same manner as we calculate these measures.

We include EBITDA and Adjusted EBITDA in this Quarterly Report on Form 10-Q because they are important measures upon which our management assesses our operating performance. We use EBITDA and Adjusted EBITDA as key performance measures because we believe they facilitate operating performance comparisons from period-to-period by excluding potential differences primarily caused by variations in capital structures, tax positions, the impact of depreciation and amortization expense on our fixed assets and the impact of stock-based compensation expense. Because EBITDA and Adjusted EBITDA facilitate internal comparisons of our historical operating performance on a more consistent basis, we also use EBITDA and Adjusted EBITDA for business planning purposes, to incentivize and compensate our management personnel, and in evaluating acquisition opportunities. In addition, we believe EBITDA, Adjusted EBITDA, and similar measures are widely used by investors, securities analysts, ratings agencies, and other parties in evaluating companies in our industry as a measure of financial performance and debt-service capabilities.

Our uses of EBITDA and Adjusted EBITDA have limitations as analytical tools and you should not consider them in isolation or as a substitute for analysis of our results as reported under U.S. GAAP. Some of these limitations are:

- EBITDA and Adjusted EBITDA do not reflect our cash expenditures for capital equipment or other contractual commitments;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and EBITDA and Adjusted EBITDA do not reflect capital expenditure requirements for such replacements;
- EBITDA and Adjusted EBITDA do not reflect changes in, or cash requirements for, our working capital needs; and
- other companies, including companies in our industry, may calculate EBITDA and Adjusted EBITDA measures differently, which reduces their usefulness as a comparative measure.

In evaluating EBITDA and Adjusted EBITDA, we anticipate that in the future we will incur expenses within these categories similar to this presentation. Our presentation of EBITDA and Adjusted EBITDA should not be construed as an inference that our future results will be unaffected by certain expenses. When evaluating our performance, you should consider EBITDA and Adjusted EBITDA alongside other financial performance measures, including U.S. GAAP results.

The following table presents a reconciliation of EBITDA and Adjusted EBITDA to our net income, the most comparable U.S. GAAP measure, for each of the periods indicated:

(amounts in thousands)	Three months ended June 30,		Six months ended June 30,	
Non-GAAP EBITDA and Adjusted EBITDA	**2019**	**2018**	**2019**	**2018**
Net income	$ 10,160	$ 14,610	$ 15,462	$ 25,368
Non-GAAP adjustments:				
Interest income	(1,394)	(673)	(2,728)	(1,216)
Provision (benefit) for income taxes	3,524	(964)	4,294	(2,035)
Depreciation and amortization	2,760	2,816	5,554	5,809
EBITDA (non-GAAP)	15,050	15,789	22,582	27,926
Stock-based compensation	1,779	3,186	5,365	6,567
Adjusted EBITDA (non-GAAP)	$ 16,829	$ 18,975	$ 27,947	$ 34,493

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various market risks, including fluctuation in interest rates, foreign currency, and exchange rates. Market risk is the potential loss arising from adverse changes in market rates and prices. We do not hold or issue financial instruments for trading purposes.

Interest rate fluctuation risk

The principal market risk we face is interest rate risk. We had cash and cash equivalents of $213.9 million as of June 30, 2019, which consisted of highly-liquid investments with a maturity of three months or less, and $42.2 million of marketable securities with maturity dates of greater than three months. The primary goals of our investment policy are liquidity and capital preservation. We do not enter into investments for trading or speculative purposes. We believe that we do not have any material exposure to changes in the fair value of these assets as a result of changes in interest rates due to the short-term nature of our cash and cash equivalents. Declines in interest rates, however, would reduce future investment income. We considered the historical volatility of short-term interest rates and determined that it was reasonably possible that an adverse change of 100 basis points could be experienced in the near term. A hypothetical 1.00% (100 basis points) increase in interest rates would not have materially impacted the fair value of our marketable securities as of June 30, 2019 and December 31, 2018. If overall interest rates had decreased by 1.00% (100 basis points), our interest income would not have been materially affected for the three months or six months ended June 30, 2019 or June 30, 2018.

Foreign currency exchange risk

The majority of our revenue is denominated in U.S. dollars while the majority of our European sales are denominated in Euros. In addition, we acquired MedSupport in the second quarter of 2017 with net assets denominated in Euros. Our results of operations, certain balance sheet balances and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. We have experienced and will continue to experience fluctuations in our net income or loss as a result of transaction gains or losses related to revaluing certain current asset and current liability balances that are denominated in currencies other than the functional currency in which they are recorded. The effect of a 10% adverse change in exchange rates on foreign denominated cash, receivables and payables as of June 30, 2019 would not have had a material effect on our financial position, results of operations or cash flows. As our operations in countries outside of the United States grow, our results of operations and cash flows will be subject to fluctuations due to changes in foreign currency exchange rates, which could harm our business in the future.

We began entering into foreign exchange forward contracts to protect our forecasted U.S. dollar-equivalent earnings from adverse changes in foreign currency exchange rates in December 2015. These hedging contracts reduce, but will not entirely eliminate, the impact of adverse currency exchange rate movements on revenue. We performed a sensitivity analysis assuming a hypothetical 10% adverse movement in foreign exchange rates to the hedging contracts and the underlying exposures described above. As of June 30, 2019, the analysis indicated that these hypothetical market movements would not have a material effect on our financial position, results of operations or cash flows. We estimate prior to any hedging activity that a 10% adverse change in exchange rates on our foreign denominated sales would have resulted in a $3.0 million decline in revenue for the first six months of 2019. We designate these forward contracts as cash flow hedges for accounting purposes. The fair value of the forward contract is separated into intrinsic and time values. The fair value of forward currency-exchange contracts is sensitive to changes in currency exchange rates. Changes in the time value are coded in other income (expense), net. Changes in the intrinsic value are recorded as a component of accumulated other comprehensive income and subsequently reclassified into revenue to offset the hedged exposures as they occur.

Inflation risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we might not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

The Company maintains a system of disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which are designed to provide reasonable assurance that information required to be disclosed in the reports that the Company files or submits under the Exchange Act, is recorded, processed, summarized and reported accurately and completely within the time periods specified in the SEC's rules and forms. These disclosure controls and procedures include, among other processes, controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Due to inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Further, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions over time, or that the degree of compliance with the policies and procedures may deteriorate. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2019. Based upon the evaluation described above, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2019, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in internal control over financial reporting

There has been no change in our internal control over financial reporting during the three months ended June 30, 2019 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Limitations on effectiveness of controls

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Because of the inherent limitations in any control system, misstatements due to error or fraud may occur and not be detected.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Securities class action and derivative lawsuits

On March 6, 2019, plaintiff William Fabbri filed a lawsuit against Inogen, Scott Wilkinson, and Alison Bauerlein, in the United States District Court for the Central District of California on behalf of a purported class of purchasers of the Company's securities. On March 21, 2019, plaintiff Steven Friedland filed a substantially similar lawsuit against the same defendants in the same court. On May 20, 2019, the court issued an order consolidating the two lawsuits under the name *In re Inogen, Inc. Sec. Litig.,* No. 2:19-cv-01643-FMO-AGR, appointing Dr. John Vasil and Paragon Fund Management as lead plaintiffs, and appointing Robbins Geller Rudman & Dowd LLP and Glancy Prongay & Murray LLP as lead plaintiffs' counsel. On July 10, 2019, the lead plaintiffs filed a consolidated amended complaint on behalf of a purported class of purchasers of the Company's common stock between November 8, 217 and May 7, 2019. The complaint generally alleges that the defendants failed to disclose that: (i) Inogen had overstated the true size of the total addressable market for its portable oxygen concentrators and had misstated the basis for its calculation of the total addressable market; (ii) Inogen had falsely attributed its sales growth to the strong sales acumen of its salesforce, rather than to deceptive sales practices; (iii) the growth in Inogen's domestic business-to-business sales to home medical equipment providers was inflated, unsustainable and was eroding direct-to-consumer sales; and (iv) Inogen's decision to focus on sales over rentals of portable oxygen concentrators harmed its ability to serve the Medicare market. The complaint seeks compensatory damages in an unspecified amount, costs and expenses, including attorneys' fees and expert fees, pre-judgment and post-judgment interest and such other relief as the court deems proper. We intend to vigorously defend ourselves against these allegations.

On June 26, 2019, plaintiff Twana Brown filed a shareholder derivative lawsuit against Inogen, Scott Wilkinson, Alison Bauerlein, Benjamin Anderson-Ray, Scott Beardsley, R. Scott Greer, Raymond Huggenberger, Heath Lukatch, Loren McFarland, and Heather Rider for breaches of their fiduciary duties as directors and/or officers of Inogen, unjust enrichment, waste of corporate assets, and violations of section 14(a) of the Securities Exchange Act of 1934, as amended. The complaint generally alleges similar claims to the securities class action. The complaint seeks compensatory damages in an unspecified amount, changes to the Company's corporate governance and internal procedures, costs and expenses, including attorneys' fees and expert fees, and such other relief as the court deems proper. On August 5, 2019, the court issued an order staying the derivative action pending the resolution of the motion to dismiss stage in *In re Inogen, Inc. Sec. Litig.* We intend to vigorously defend ourselves against these allegations.

Other litigation

In the normal course of business, we are from time to time involved in various legal proceedings or potential legal proceedings, including matters involving employment, product liability and intellectual property. We carry insurance, subject to specified deductibles under our policies, to protect against losses from certain liabilities and costs. At this time, we do not anticipate that any of these proceedings arising in the normal course of business will have a material adverse effect on our business. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources, and other factors.

Item 1A. Risk Factors

We operate in a rapidly changing environment that involves numerous uncertainties and risks. In addition to the other information included in this Quarterly Report on Form 10-Q, the following risks and uncertainties may have a material and adverse effect on our business, financial condition, results of operations, or stock price. You should consider these risks and uncertainties carefully, together with all of the other information included or incorporated by reference in this Quarterly Report on Form 10-Q. The risks and uncertainties described below may not be the only ones we face. If any of the risks or uncertainties we face were to occur, the trading price of our securities could decline, and you may lose all or part of your investment. This Quarterly Report on Form 10-Q also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of factors that are described below and elsewhere in this report.

Risks related to our business and strategy

We face intense international, national, regional and local competition and if we are unable to compete successfully, it could have an adverse effect on our revenue, revenue growth rate, if any, and market share.

The long-term oxygen therapy market is a highly competitive industry. We compete with a number of manufacturers and distributors of portable oxygen concentrators, as well as providers of other long-term oxygen therapy solutions such as home delivery of oxygen tanks or cylinders, stationary concentrators, transfilling concentrators, and liquid oxygen.

Our significant manufacturing competitors are Respironics (a subsidiary of Koninklijke Philips N.V.), Invacare Corporation, Caire Medical (subsidiary of NGK Spark Plug), DeVilbiss Healthcare (a subsidiary of Drive Medical), O2 Concepts, Precision Medical, Resmed, and Gas Control Equipment (subsidiary of Colfax). Additional competitors have also pre-announced upcoming product launches of portable oxygen concentrators expected in 2019 including 3B Medical, SysMed, and Bellascura. Given the relatively straightforward regulatory path in the oxygen therapy device manufacturing market, we expect that the industry will become increasingly competitive in the future. For example, some major competitors have implemented direct-to-consumer sales models which may increase their competitiveness and sales to patients and we have recently seen the cost per generated lead trend higher than historical averages that may in part be due to increased competition; however, these strategies are limited to direct-to-consumer sales and do not include direct-to-consumer rentals where they would be responsible to meet national accreditation and state-by-state licensing requirements and secure Medicare billing privileges. Manufacturing companies compete for sales to providers primarily on the basis of price, quality/reliability, financing, bundling, product features, and service.

For many years, Lincare, Inc. (a subsidiary of the Linde Group), Apria Healthcare, Inc., AdaptHealth (formerly QMES LLC), Aerocare Holdings, Inc. and Rotech Healthcare, Inc. have been among the market leaders in providing long-term oxygen therapy, while the remaining long-term oxygen therapy market is serviced by local providers. Because many long-term oxygen therapy providers may have difficulty providing service at the prevailing Medicare reimbursement rates, we expect more industry consolidation and volatility in ordering patterns based on how providers are restructuring their businesses and their access to capital. Oxygen therapy providers compete primarily on the basis of product features and service, rather than price, since reimbursement levels are established by Medicare and Medicaid, or by the individual determinations of private payors.

In addition, following our planned acquisition of New Aera, Inc. (New Aera), our target market and the scope of our competition is expected to expand. Additional competitors of the New Aera business and the technology to be acquired include Breathe Technologies, Inc. (recently announced to be acquired by Hill-Rom Holdings, Inc), Breas Medical, Ventec Life Systems, and Covidien.

Some of our competitors are large, well-capitalized companies with greater resources than we have. As a consequence, they are able to spend more aggressively on product development, marketing, sales and other product initiatives than we can. Some of these competitors have:

- significantly greater name recognition;
- established relationships with healthcare professionals, customers and third-party payors;
- established distribution networks;
- additional lines of products, and the ability to offer rebates or bundle products to offer higher discounts, lower pricing, longer warranties, financing or extended terms, other incentives to gain a competitive advantage;
- greater history in conducting research and development, manufacturing, marketing and obtaining regulatory approval for oxygen device products; and
- greater financial and human resources for product development, sales and marketing, and patent litigation.

As a result, our competitors may be able to respond more quickly and effectively than we can due to new or changing opportunities, technologies, standard regulatory and reimbursement development and customer requirements. In light of these advantages that our competitors maintain, even if our technology and direct-to-consumer distribution strategy is more effective than the technology and distribution strategy of our competitors, including those who have adopted or may in the future adopt direct-to-consumer sales models, current or potential customers might accept competitor products and services in lieu of purchasing our products. We anticipate that we will face increased competition in the future as existing companies and competitors develop new or improved products and distribution strategies and as new companies enter the market with new technologies and distribution strategies. We may not be able to compete effectively against these organizations. Our ability to compete successfully and to increase our market share is dependent upon our reputation for providing responsive, professional and high-quality products and services and achieving strong customer satisfaction. Increased competition in the future could adversely affect our revenue, revenue growth rate, margins and market share.

If we are unable to continue to enhance our existing products and develop and market new products that respond to customer needs and preferences and achieve market acceptance, we may experience a decrease in demand for our products and our business could suffer.

We may not be able to compete as effectively with our competitors and ultimately satisfy the needs and preferences of our customers unless we can continue to enhance existing products and develop new innovative products. Product development requires significant financial, technological and other resources. While we expended $1.5 million and $1.8 million for the three months ended June 30, 2019 and June 30, 2018, respectively, and $3.1 million and $3.2 million for the six months ended June 30, 2019 and June 30, 2018, respectively, in research and development efforts, we cannot assure that this level of investment will be sufficient to maintain a competitive advantage in product innovation, which could cause our business to suffer. In addition, following our planned acquisition of New Aera, we plan to sell the Tidal Assist® Ventilator (TAV®) through our domestic direct-to-consumer sales channel and our business-to-business sales channels worldwide, pending regulatory clearances outside of the United States. We also plan to incorporate the TAV technology directly into our Inogen One portable oxygen concentrators. Product improvements and new product introductions also require significant planning, design, development, patent protection, and testing at the technological, product, and manufacturing process levels and we may not be able to timely develop product improvements or new products or obtain necessary patent protection and regulatory clearances or approvals for such product improvements or new products in a timely manner, or at all. Our competitors' new products may enter the market before our new products reach market, be more effective with more features, obtain better market acceptance, or render our products obsolete. Any new products that we develop or introduce, including the TAV, may not receive market acceptance or otherwise generate any meaningful sales or profits for us relative to our expectations based on, among other things, existing and anticipated investments in manufacturing capacity and commitments to fund advertising, marketing, promotional programs and research and development.

We depend on a limited number of customers for a significant portion of our sales revenue and the loss of, or a significant shortfall in demand from, these customers could have a material adverse effect on our financial condition and operating results.

We receive a significant amount of our sales revenue from a limited number of customers, including distributors, HME oxygen providers, our private label partner and resellers. For the three months ended June 30, 2019 and June 30, 2018, sales revenue to our top 10 customers accounted for approximately 34.3% and 40.4%, respectively, of our total revenue. No single customer represented more than 10% of our total revenue for the three months ended June 30, 2019, and one single customer represented more than 10% of our total revenue for the three months ended June 30, 2018. For the six months ended June 30, 2019 and June 30, 2018, sales revenue to our top 10 customers accounted for approximately 34.5% and 40.4%, respectively, of our total revenue. No single customer represented more than 10% of our total revenue for the six months ended June 30, 2019 and one single customer represented more than 10% of our total revenue for the six months ended June 30, 2018. We expect that sales to relatively few customers will continue to account for a significant percentage of our total revenue in future periods. Our future success will significantly depend upon the timing and volume of business from our largest customers and the financial and operational success of these customers. However, we can provide no assurance that any of these customers or any of our other customers will continue to purchase our products at current levels, pricing, or at all, and our revenue could fluctuate significantly due to changes in customer order levels, economic conditions, the adoption of competitive products, or the loss of, reduction of business with, or less favorable terms with any of our largest customers. For example, we have previously experienced a decline in sales to one large national homecare provider who purchased through our private label partner. Other home medical equipment providers have communicated to us that they continue to be subject to capital constraints and certain providers have indicated that they intend to reduce or limit purchases in the future. If we were to lose one of our key customers or have a key customer significantly reduce its volume of business with us, such as we previously experienced with the large national homecare provider, our revenue may be materially reduced and there would be an adverse effect on our business, financial condition and results of operations.

We obtain some of the components, subassemblies and completed products included in our Inogen One systems and our Inogen At Home systems from a single source or a limited group of manufacturers or suppliers, and the partial or complete loss of one or more of these manufacturers or suppliers could cause significant production delays, an inability to meet customer demand, substantial loss in revenue, and an adverse effect on our financial condition and results of operations.

We utilize single-source suppliers for some of the components and subassemblies we use in our Inogen One systems and our Inogen At Home systems. For example, we have elected to source certain key components from single sources of supply, including our batteries, motors, valves, and some molded plastic components. Our dependence on single-source suppliers of components may expose us to several risks, including, among other things:

- our suppliers may encounter financial hardships as a result of unfavorable economic and market conditions unrelated to our demand for components, which could inhibit their ability to fulfill our orders and meet our requirements;

- suppliers may fail to comply with regulatory requirements, be subject to lengthy compliance, validation or qualification periods, or make errors in manufacturing components that could negatively affect the performance or safety of our products or cause delays in supplying of our products to our customers;
- newly identified suppliers may not qualify under the stringent quality regulatory standards to which our business is subject, which could inhibit their ability to fulfill our orders and meet our requirements;
- we or our suppliers may not be able to respond to unanticipated changes in customer orders, and if orders do not match forecasts, we or our suppliers may have excess or inadequate inventory of materials and components;
- we may be subject to price fluctuations due to a lack of long-term supply arrangements for key components or changes in import tariffs;
- we may experience delays in delivery by our suppliers due to customs clearing delays, shipping delays, scarcity of raw materials or changes in demand from us or their other customers;
- we or our suppliers may lose access to critical services and components, resulting in an interruption in the manufacture, assembly and shipment of our systems;
- our suppliers may be subject to allegations by other parties of misappropriation of proprietary information in connection with their supply of products to us, which could inhibit their ability to fulfill our orders and meet our requirements;
- fluctuations in demand for products that our suppliers manufacture for others may affect their ability or willingness to deliver components to us in a timely manner;
- our suppliers may wish to discontinue supplying components or services to us; and
- we may not be able to find new or alternative components or reconfigure our system and manufacturing processes in a timely manner if the necessary components become unavailable.

We have in the past experienced supply problems with some of our suppliers and may again experience problems in the future. For example, we have previously had issues with our suppliers sourcing certain components of our Inogen One products. If we had not been able to obtain sufficient quantities of the required component, we would have been required to delay manufacturing until additional supplies become available, or we would have been required to validate an alternative component. We may not be able to quickly establish additional or replacement suppliers, particularly for our single source components or subassemblies. Any interruption or delay in the supply of components or subassemblies, or our inability to obtain components or subassemblies from alternate sources at acceptable prices in a timely manner, could impair our ability to meet the demand of our customers and cause them to cancel orders or switch to competitive products.

In addition, we may be deemed to manufacture or contract to manufacture products that contain certain minerals that have been designated as “conflict minerals” under the Dodd-Frank Wall Street Reform and Consumer Protection Act. As a result, we may be required to perform due diligence to determine the origin of such minerals and disclose and report whether or not such minerals originated in the Democratic Republic of the Congo or adjoining countries. The implementation of these requirements could adversely affect the sourcing, availability, and pricing of minerals used in the manufacture of our products. In addition, we have incurred additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products. If any of these risks materialize, costs could significantly increase and our ability to meet demand for our products could be impacted. If we fail to comply with the applicable regulations, we could be required to pay civil penalties, face criminal prosecution and, in some cases, be prohibited from distributing our products in commerce until the products or component substances are brought into compliance. If we are unable to satisfy commercial demand for our Inogen One systems and Inogen At Home systems in a timely manner, our ability to generate revenue would be impaired, market acceptance of our products could be adversely affected, and customers may instead purchase or use alternative products. In addition, we could be forced to secure new or alternative components and subassemblies through a replacement supplier. Finding alternative sources for these components and subassemblies could be difficult in certain cases and may entail a significant amount of time and disruption. In some cases, we would need to change the components or subassemblies if we sourced them from an alternative supplier. This, in turn, could require a redesign of our Inogen One systems and Inogen At Home systems and, potentially, require additional Food and Drug Administration (FDA) clearance or approval before we could use any redesigned product with new components or subassemblies, thereby causing further costs and delays that could adversely affect our business, financial condition and results of operations.

A significant majority of our rental patients who use our product have health coverage under the Medicare program, and recently enacted and future changes in the reimbursement rates or payment methodologies under Medicare, Medicaid and other government programs have affected and could continue to materially and adversely affect our business and operating results.

As a provider of oxygen equipment rentals, we depend heavily on Medicare reimbursement as a result of the higher proportion of elderly persons suffering from chronic long-term respiratory conditions. Medicare Part B, or Supplementary Medical Insurance Benefits, provides coverage to eligible beneficiaries that include items of durable medical equipment for use in the home, such as oxygen equipment and other respiratory devices. We believe that approximately 60% of long-term oxygen therapy patients in the United States have primary coverage under traditional fee-for-service Medicare Part B. There are increasing pressures on Medicare to control healthcare costs and to reduce or limit reimbursement rates for home medical products.

Legislation, including the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, the Deficit Reduction Act of 2005, the Medicare Improvements for Patients and Providers Act of 2008, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, and the 21st Century Cures Act (Cures Act) contain provisions that directly impact reimbursement for the durable medical equipment products provided by us:

- The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 significantly reduced reimbursement for inhalation drug therapies beginning in 2005, reduced payment amounts for certain durable medical equipment, including oxygen, beginning in 2005, froze payment amounts for other covered home medical equipment items through 2008, established a competitive bidding program for home medical equipment and implemented quality standards and accreditation requirements for durable medical equipment suppliers.
- The Deficit Reduction Act of 2005 limited the total number of continuous rental months for which Medicare will pay for oxygen equipment to 36 months, after which time there is generally no additional reimbursement to the supplier (other than for periodic, in-home maintenance and servicing). The Deficit Reduction Act of 2005 also provided that title of the equipment would transfer to the beneficiary, which was later repealed by the Medicare Improvements for Patients and Providers Act of 2008. For purposes of the rental cap, the Deficit Reduction Act of 2005 provided for a new 36-month rental period that began January 1, 2006 for all oxygen equipment. After the 36th continuous month during which payment is made for the oxygen equipment, the supplier is generally required to continue to furnish the equipment during the period of medical need for the remainder of the useful lifetime of the equipment, provided there are no breaks in service due to medical necessity that exceed 60 days. The reasonable useful lifetime for our portable oxygen equipment is 60 months. After 60 months, if the patient requests, and the patient meets Medicare coverage criteria, the rental cycle starts over and a new 36-month rental period begins. There are no limits on the number of 60-month cycles over which a Medicare patient may receive benefits and an oxygen therapy provider may receive reimbursement, so long as such equipment continues to be medically necessary for the patient. We anticipate that the Deficit Reduction Act of 2005 oxygen payment rules will continue to negatively affect our net revenue on an ongoing basis, as each month additional customers reach the capped rental period in month thirty-seven, resulting in potentially two or more years without rental income from these customers while we continue to incur customer service and maintenance costs. Our capped patients as a percentage of total patients on service was approximately 20.2% as of June 30, 2019, which is higher than the capped patients as a percentage of total patients on service of approximately 17.7% as of June 30, 2018. The percentage of capped patients may fluctuate over time as new patients come on service, patients come off of service before and during the capped rental period, and existing patients enter the capped rental period. We cannot predict the potential impact to rental revenues in future periods associated with patients in the capped rental period.
- The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, includes, among other things, new face-to-face physician encounter requirements for certain durable medical equipment and home health services, and a requirement that by 2016, the competitive bidding process must be nationalized or prices in non-competitive bidding areas must be adjusted to match competitive bidding prices. As of January 1, 2017, CMS has decreased prices for durable medical equipment in non-competitive bidding areas to match competitive bidding prices.
- The Cures Act was passed in December 2016 and included a provision to roll-back the second cut to the non-CBA areas that was effective July 1, 2016 through December 31, 2016. Reimbursement in these areas was increased to the rates experienced in the period from January 1, 2016 through June 30, 2016. This led to a benefit in rental revenue of $2.0 million in the fourth quarter of 2016 and $0.2 million in the first quarter of 2017. Effective January 1, 2017, rates are set at 100% of the adjusted fee schedule amount, based on the regional competitive bidding rates. The Cures Act also called for a study of the impact of the competitive bidding pricing on rural areas.

These legislative provisions as currently in effect have had and may continue to have a material and/or adverse effect on our business, financial condition and results of operations.

The Health and Human Services (HHS) Office of Inspector General (OIG) has recommended states to review Medicaid reimbursement for durable medical equipment (DME) and supplies. The OIG cites an earlier report estimating that four states (California, Minnesota, New York, and Ohio) could have saved more than $18.1 million on selected DME items if their Medicaid prices were comparable to those under round one of the Medicare competitive bidding program. Since issuing those reports, the OIG identified $12 million in additional savings that the four states could have obtained on the selected items by using pricing similar to the Medicare round two competitive bidding and national mail-order programs. In light of varying Medicaid provider rates for DME and the potential for lower spending, the OIG recommends that CMS (1) seek legislative authority to limit state Medicaid DME reimbursement rates to Medicare program rates, and (2) encourage further reduction of Medicaid reimbursement rates through competitive bidding or manufacturer rebates (the OIG did not determine the cost of implementing a rebate or competitive bidding program in each state). This was effective beginning January 1, 2018.

On January 28, 2016, the Department of Health and Human Services (DHHS) published a final rule to implement Medicare's face-to-face provisions for home health and DME under the Medicaid program, effective July 1, 2016. Medicaid programs are run by state agencies that must coordinate with state legislative bodies, therefore the state agencies have until July 1, 2017 or July 1, 2018 (depending on the timing of their legislative sessions) to allow state agencies to publish compliant initiatives on this rule. All states except Montana, Nevada, North Dakota, and Texas were expected to initiate this requirement effective July 1, 2017. Montana, Nevada, North Dakota, and Texas were expected to implement the requirements by July 1, 2018. The Medicaid definition of medical supplies, equipment and appliances were aligned with the Medicare definitions. In addition, the DHHS has implemented the requirement for a face-to-face visit related to the beneficiary's primary need for medical equipment within 6 months prior to the start of certain durable medical equipment services, including oxygen. These legislative provisions could have an adverse effect on our business, financial condition and results of operations.

Due to budgetary shortfalls, many states are considering, or have enacted, cuts to their Medicaid programs. In addition, many private payors reimburse at a percentage of the Medicare rates. Medicare, Medicaid and private payor reimbursement rate cuts have included, or may include, elimination or reduction of coverage for our products, amounts eligible for payment under co-insurance arrangements, or payment rates for covered items. Continued state budgetary pressures could lead to further reductions in funding for the reimbursement for our products which, in turn, would adversely affect our business, financial condition and results of operations.

On January 17, 2017, the U.S. Department of Health and Human Services published a final rule effective March 20, 2017 to address the appeals backlog that includes allowing certain decisions to be made by the Medicare Appeals Council to set precedent for lower levels of appeal, expansion of the pool of available adjudicators, and increasing decision-making consistency among the levels of appeal. In addition, it included provisions to improve the efficiency by streamlining the appeals process, allowing attorneys to handle some procedural matters at the administrative law judge level, and proposed funding increases and legislative actions outlined in the federal budget for 2017. DHHS estimates this could eliminate the backlog in appeals by 2021. However, if this plan is not effective, the appeals backlog could increase, which could increase our collection times and decrease our cash flow, increase billing administrative costs, and/or increase the provision for rental revenue adjustments, which would adversely affect our business, financial condition and results of operations.

The competitive bidding process under Medicare could negatively affect our business and financial condition.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 requires the Secretary of Health and Human Services to establish and implement programs under which competitive acquisition areas are established throughout the United States for purposes of awarding contracts for the furnishing of competitively priced items of durable medical equipment, including oxygen equipment.

Effective January 1, 2019, Medicare beneficiaries may receive durable medical equipment from any Medicare-enrolled supplier until new contracts are awarded for the competitive bidding Round 2021, which is expected to begin on January 1, 2021. Reimbursement rates between January 1, 2019 and December 31, 2020 will be set at the current pricing level throughout the United States for all Medicare patients, subject to Consumer Price Index (CPI) and budget neutrality adjustments. Pricing in competitive bidding areas will be subject to annual CPI adjustments beginning in 2019 until Round 2021 begins. However, CMS also changed the calculation on budget neutrality to apply the offset to all oxygen and oxygen equipment classes beginning January 1, 2019 instead of previously only applying these adjustments to stationary oxygen equipment and oxygen contents. Based on these CPI and budget neutrality adjustments, effective January 1, 2019, the average Medicare rates were reduced to $72.92 a month for E1390 and $35.72 a month for E1392 in these regions that were previously subject to competitive bidding. Medicare also established new payment classes for liquid oxygen equipment and high flow portable liquid oxygen contents effective January 1, 2019.

In the next round of DMEPOS competitive bidding program, there have been some revisions to the bidding methodology including the plan to implement surety bond requirements, lead item pricing, and setting reimbursement rates at the maximum winning bid rate instead of the median winning bid rate. In the prior round of competitive bidding, the product category where our products fell was respiratory equipment and related supplies and accessories, which included oxygen equipment, continuous positive airway pressure (CPAP) devices and respiratory assist devices (RADs) and related supplies and accessories. In the next round of bidding, oxygen and oxygen equipment is its own product category and the lead item has been established as E1390. However, due to the lead item pricing methodology based on the 2015 standard Medicare fee schedule, E1392 reimbursement rates could be reduced significantly (we estimate approximately42%) even if E1390 reimbursement rates do not change. This would lead to combined E1390 plus E1392 reimbursement rates to decrease by approximately 15%. The bidding window opened on July 16, 2019. It is unclear how pricing will be impacted due to these new bids. We expect contracts and pricing to be announced in 2020.

In addition to regional pricing, CMS imposed different pricing on "frontier states" and rural areas. CMS defines frontier states as states where more than 50% of the counties in the state have a population density of 6 people or less per square mile and rural states are defined as states where more than 50% of the population lives in rural areas per census data. Current frontier states include MT, ND, SD and WY; rural states include ME, MS, VT and WV; and non-contiguous United States areas include AK, HI, Guam and Puerto Rico. Effective June 1, 2018 through December 31, 2020, for frontier and rural states, frontier and rural zip codes in non-frontier/rural states and non-contiguous United States areas, the single payment amount will be the 50/50 blended reimbursement rates based on an average of the pre-competitive reimbursement bidding rates and the current average reimbursement rates to account for higher servicing costs in these areas. In 2019, this rate is $134.71 a month for E1390 and $44.32 a month for E1392. We estimate that less than 15% of our patients are eligible to receive the higher reimbursement rates based on the geographic locations of our current patient population.

Cumulatively in previous rounds of competitive bidding, we were offered contracts for a substantial majority of the CBAs and product categories for which we submitted bids. Effective January 1, 2017, we believe we had access to over 90% of the Medicare oxygen therapy market based on our analysis of the 103 CBAs that we won out of the 130 total CBAs. These 130 CBAs represent approximately 39% of the market with the remaining approximately 61% of the market not subject to competitive bidding. As of January 1, 2019, and until the next round of competitive bidding, we can choose to accept Medicare oxygen patients throughout the United States. As of July 2018, we currently operate in all 50 states in the U.S. We did not sell or rent to patients in Hawaii due to the licensure requirements from inception to June 2018.

We cannot guarantee that we will be offered contracts in subsequent rounds of competitive bidding. In all five rounds of competitive bidding in which we have participated, we have gained access to certain CBAs and been excluded from other CBAs.

Medicare revenue, including patient co-insurance and deductible obligations, represented 4.1% and 4.1% of our total revenue in the three months ended June 30, 2019 and June 30, 2018, respectively, and 4.5% and 4.6% in the six months ended June 30, 2019 and June 30, 2018, respectively.

Medicare reimbursement for oxygen rental equipment is limited to a maximum of 36 months within a 60-month service period, and the equipment remains the property of the home oxygen supplier. The supplier that billed Medicare for the 36th month of service continues to be responsible for the patient's oxygen therapy needs for months 37 through 60, and there is generally no additional reimbursement for oxygen generating portable equipment for these later months. CMS does not separately reimburse suppliers for oxygen tubing, cannulas and supplies that may be required for the patient. The supplier is required to keep the equipment provided in working order and in some cases, CMS will reimburse for repair costs. At the end of the five-year useful life of the equipment, the patient may request replacement equipment and, if he or she can be re-qualified for the Medicare benefit, a new maximum 36-month payment cycle out of the next 60 months of service would begin. The supplier may not arbitrarily issue new equipment. We have analyzed the potential impact to revenue associated with patients in the capped rental period and have deferred $0 associated with the capped rental period as of June 30, 2019 and June 30, 2018. Our capped patients as a percentage of total patients on service was approximately 20.2% as of June 30, 2019, which is higher than the capped patients as a percentage of total patients on service of approximately 17.7% as of June 30, 2018. The percentage of capped patients may fluctuate over time as new patients come on service, patients come off of service before and during the capped rental period, and existing patients enter the capped rental period.

Our obligations to service Medicare patients over the rental period include supplying working equipment that meets each patient's oxygen needs pursuant to his/her doctor's prescription and certificate of medical necessity form and supplying all disposables required for the patient to operate the equipment, including cannulas, filters, replacement batteries, carts and carry bags, as needed. If the equipment malfunctions, we must repair or replace the equipment. We determine what equipment the patient receives, as long as that equipment meets the physician's prescription, and we can deploy used assets in working order as long as the prescription requirements are met. We must also procure a recertification of the certificate of medical necessity from the patient's doctor to confirm the patient's need for oxygen therapy one year after the patient first receives oxygen therapy and one year after each new 36-month reimbursement period begins. The patient can choose to receive oxygen supplies and services from another supplier at any time, but the supplier may only transition the patient to another supplier in certain circumstances.

On May 15, 2019, a bi-partisan bill was introduced in the House of Representatives that would provide relief from competitive bidding in non-bid areas. As of August 1, 2019, there were 32 co-sponsors on this bill. If passed, the bill would provide retroactive relief to rural areas by making the 50/50 blended reimbursement rate in rural and noncontiguous areas permanent and by introducing a 75/25 blended reimbursement rate for areas other than rural and noncontiguous. The legislation also proposes to remedy a double-dip cut to oxygen payments caused by the misapplication of a 2006 budget neutrality offset balancing increased utilization for oxygen generating portable equipment with lower reimbursement for stationary equipment.

On March 11, 2019, the current presidential administration sent Congress a 2020 budget proposal that included language on competitive bidding. Specifically, the proposal would eliminate the requirement under the competitive bidding program that CMS pay a single payment amount based on the median bid price, proposing instead that CMS pay winning suppliers at their own bid amounts. Additionally, this proposal would expand competitive bidding to all areas of the country, including rural areas, which will be based on competition in those areas rather than on competition in urban areas. This specific proposal is estimated to save the government $7.1 billion in Medicare savings and $0.4 billion in Medicaid savings over 10 years. In addition to changes to competitive bidding, the 2020 budget proposal would enable CMS not to impose the face-to-face requirement on all providers for durable medical equipment. Furthermore, the proposal seeks to address excessive billing of durable medical equipment that requires refills or serial claims. Specifically, Medicare would gain authority to test whether using a benefits manager for serial durable medical equipment claims would result in lower improper payments and reductions in inappropriate utilization. The benefits manager would be responsible for ensuring beneficiaries were receiving the correct quantity of supplies or service for the appropriate time period. In addition, the proposal allows an administrative penalty of $50 for Part B items/services and $100 for Part A services on providers for ordering high-risk, high-cost items or services without proper documentation, such as diagnosis or encounter data. Lastly, the proposal would expand prior authorization to additional items and services that are both high-cost and at high-risk for improper payments. These provisions were not included in the latest omnibus budget, so it is unclear if any of these proposals will be implemented. We believe additional cuts to reimbursement would continue to drive conversion to non-delivery technologies, including portable oxygen concentrators, however this could also exacerbate patient access issues for treatment.

On July 29, 2019, CMS issued a proposed rule to establish methodologies to modernize pricing of new DMEPOS items and services based on commercial pricing data. In addition, the proposed rule recommends streamlining requirements related to face-to-face encounters, written orders prior to delivery and/or prior authorizations to reduce provider confusion. Lastly, the proposed rule recommends revising the existing DMEPOS competitive bidding program regulations to recognize that changes of ownership may occur on shorter timeframes and revising the submission of a hearing request in notices of breach of contract. CMS is soliciting comments on this proposed rule through September 27, 2019.

Although we continue to monitor developments regarding the implementation of the competitive bidding program, we cannot predict the outcome of the competitive bidding program on our business when fully implemented, nor the Medicare reimbursement rates that will be in effect in future years for the items subject to competitive bidding, including our products. We expect that the stationary oxygen and non-delivery ambulatory oxygen reimbursement rates will continue to fluctuate, and a large negative payment adjustment would adversely affect our business, financial condition and results of operations.

The Medicare Fee-For-Service (FFS) sequestration reduction has and may continue to negatively affect our revenue and profits.

Medicare FFS claims with dates of service on or after April 1, 2013 are subject to a 2% reduction in Medicare payment, including claims for DMEPOS, including in competitive bidding areas. The claims payment adjustment is applied to all claims after determining co-insurance, any applicable deductible, and any applicable Medicare secondary payment adjustments. These reductions are included in rental revenue adjustments. This sequestration reduction will continue until further notice. As a result, this could adversely affect our financial condition and results of operations.

The implementation of prior authorization rules for DMEPOS under Medicare could negatively affect our business and financial condition.

CMS has issued a final rule to require Medicare prior authorization (PA) for certain durable medical equipment, prosthetics, orthotics, and supplies (DMEPOS) that the agency characterizes as "frequent subject to unnecessary utilization". The final rule was published on December 30, 2015 and specified an initial master list of 135 items that could potentially be subject to PA. Initially stationary oxygen rentals (code E1390) was included on the master list, but it was later removed. On April 22, 2019, stationary oxygen rentals (E1390) was again added to the list of potential codes that could be subject to PA. The master list is updated annually and published in the Federal Register. The presence of an item on the master list does not automatically mean that a PA is required. CMS will select a subset of these master list items for its "Required Prior Authorization List". There will be a notice period of at least 60 days prior to implementation. The ruling does not create any new clinical documentation requirements; instead the same information necessary to support Medicare payment will be required *prior* to the item being furnished to the beneficiary. CMS has proposed that reasonable efforts are made to provide a PA decision within 10 days of receipt of all applicable information, unless this timeline could seriously jeopardize the life or health of the beneficiary or the beneficiary's ability to regain maximum function, in which case the proposed PA decision would be 2 business days. CMS will issue additional sub-regulatory guidance on these timelines in the future. If our products are subject to prior authorization, it could reduce the number of patients qualified to come on service using their Medicare benefits, it could delay the start of those patients while we wait for the prior authorization to be received, and/or it could decrease sales productivity. As a result, this could adversely affect our business, financial conditions and results of operations.

Healthcare reform measures may have a material adverse effect on our business and results of operations.

In the United States, the legislative landscape, particularly as it relates to healthcare regulation and reimbursement coverage, continues to evolve. In March 2010, the Patient Protection and Affordable Care Act was passed, which has the potential to substantially change healthcare financing by both governmental and private insurers, and significantly impact the U.S. medical device industry.

In addition, other legislative changes have been proposed and adopted in the United States since the Patient Protection and Affordable Care Act was enacted. On August 2, 2011, the Budget Control Act of 2011 created, among other things, measures for spending reductions by Congress. A Joint Select Committee on Deficit Reduction, tasked with recommending a targeted deficit reduction of at least $1.2 trillion for the years 2013 through 2021, was unable to reach required goals, thereby triggering the legislation's automatic reduction to several government programs. This includes aggregate reductions of Medicare reimbursements to providers up to 2% per fiscal year, which went into effect on April 1, 2013, and will remain in effect through 2024 unless additional Congressional action is taken. We expect that additional state and federal healthcare reform measures will be adopted in the future, any of which could limit the amounts that federal and state governments will pay for healthcare products and services, which could result in reduced demand for our products or additional pricing pressures.

In addition to the legislative changes discussed above, the Patient Protection and Affordable Care Act also requires healthcare providers to voluntarily report and return an identified overpayment within 60 days after identifying the overpayment. Failure to repay the overpayment within 60 days will result in the claim being considered a "false claim" and the healthcare provider will be subject to False Claims Act liability.

State legislative bodies also have the right to enact legislation that would impact requirements of home medical equipment providers, including oxygen therapy providers. Some states have already enacted legislation that would require in-state facilities. We are monitoring all state requirements to maintain compliance with state-specific legislation and access to service patients in these states. To the extent such legislation is enacted, it could result in increased administrative costs or otherwise exclude us from doing business in a particular state, which would adversely impact our business, financial condition and results of operations.

We face uncertainties that might result from modification or repeal of any of the provisions of the Patient Protection and Affordable Care Act, including as a result of current and future executive orders and legislative actions. The impact of those changes on us and potential effect on the durable medical equipment industry as a whole is currently unknown. But, any changes to the Patient Protection and Affordable Care Act are likely to have an impact on our results of operations and may have a material adverse effect on our results of operations. We cannot predict what other healthcare programs and regulations will ultimately be implemented at the federal or state level or the effect of any future legislation or regulation in the United States may have on our business.

We depend upon reimbursement from Medicare, private payors, Medicaid and payments from patients for a significant portion of our revenue, and if we fail to manage the complex and lengthy reimbursement process, our business and operating results could be adversely affected.

A significant portion of our rental revenue is derived from reimbursement by third-party payors. We accept assignment of insurance benefits from customers and, in a majority of cases, invoice and collect payments directly from Medicare, private payors and Medicaid, as well as direct from patients under co-insurance provisions. For the three months ended June 30, 2019 and June 30, 2018, approximately 5.1% and 5.4%, respectively, and for the six months ended June 30, 2019 and June 30, 2018, approximately 5.5% and 6.1%, respectively, of our total revenue was derived from Medicare, private payors, Medicaid, and individual patients who directly receive reimbursement from third-party payors and this percentage could increase as a percent of total revenue if we increase net patient additions faster than our sales revenue growth.

Our financial condition and results of operations may be affected by the healthcare industry's reimbursement process, which is complex and can involve lengthy delays between the time that a product is delivered to the consumer and the time that the reimbursement amounts are settled. Depending on the payor, we may be required to obtain certain payor-specific documentation from physicians and other healthcare providers before submitting claims for reimbursement. Certain payors have filing deadlines and they will not pay claims submitted after such time. We are also subject to extensive pre-payment and post-payment audits by governmental and private payors that could result in material delays, refunds of monies received or denials of claims submitted for payment under such third-party payor programs and contracts. We cannot ensure that we will be able to continue to effectively manage the process, it would adversely affect our business, financial condition and results of operations.

We do not have long-term supply contracts with many of our third-party suppliers.

We purchase components and subassemblies from third-party suppliers, including some of our single-source suppliers, through purchase orders and do not have long-term supply contracts with many of these third-party suppliers. Many of our third-party suppliers, therefore, are not obligated to perform services or supply products to us for any specific period, in any specific quantity or at any specific price, except as may be provided in a particular purchase order. We do not maintain large volumes of inventory from most of these suppliers. If we inaccurately forecast demand or fail to place orders timely enough relative to fluctuating lead time requirements for components or subassemblies, our ability to manufacture and commercialize our Inogen One systems and Inogen At Home systems could be delayed and our competitive position and reputation could be harmed. In addition, if we fail to effectively manage our relationships with these suppliers, we may be required to change suppliers which would be time consuming and disruptive and could adversely affect our business, financial condition and results of operations.

If our manufacturing facilities become unavailable or inoperable, we could be unable to continue manufacturing our Inogen One systems and Inogen At Home systems and, as a result, our business, financial condition and results of operations could be adversely affected until we are able to secure a new facility.

We assemble our Inogen One concentrators and Inogen At Home concentrators at our facilities in Richardson, Texas and Goleta, California and through our contract manufacturer in the Czech Republic. In the fourth quarter of 2017, we began using a contract manufacturer in the Czech Republic to assemble our Inogen One G3 concentrators for our international customers. The Company expects to manufacture the TAV in Goleta, California. No other manufacturing facilities are currently available to us, particularly facilities of the size and scope of our Texas facility. Our facilities and the equipment we use to manufacture our Inogen One systems and Inogen At Home systems would be costly to replace and could require substantial lead time to procure, repair or replace. Our facilities may be harmed or rendered inoperable by natural or man-made disasters, including, but not limited to, fire, flood, earthquakes and power outages, which may render it difficult or impossible for us to manufacture our products for some period of time. If any of our facilities become unavailable to us, we cannot provide assurances that we will be able to secure and equip a new manufacturing facility on acceptable terms, in a timely manner. The inability to manufacture our products, combined with delays in replacing parts inventory and manufacturing supplies and equipment, may result in the loss of customers and/or harm our reputation, and we may be unable to reestablish relationships with those customers in the future. Although we have insurance coverage for certain types of disasters and business interruptions which may help us recover some of the costs of damage to our property, costs of recovery and lost income from the disruption of our business, insurance coverage of certain perils may be limited or unavailable at cost effective rates and may therefore not be sufficient to cover any or all of our potential losses and may not continue to be available to us on acceptable terms, or at all. If our manufacturing capabilities are impaired, we could not be able to manufacture, store, and ship our products in sufficient quantity or a cost effective or timely manner, which would adversely affect our business, financial condition and results of operations.

We rely upon a third-party contract manufacturer for certain manufacturing operations and our business and results of operations may be adversely affected by risks associated with their business, financial condition and the geography in which they operate.

Beginning in the fourth quarter of 2017, we began utilizing a third-party contract manufacturer located in the Czech Republic for production of a portion of our Inogen One G3 concentrators. In 2018, our contract manufacturer produced the vast majority of the Inogen One G3 concentrators required to support our European demand and we expect this to continue in 2019. There are a number of risks associated with our dependence on a contract manufacturer, including:

- reduced control over delivery schedules and planning;
- reliance on the quality assurance procedures of a third party;
- risks associated with our contract manufacturer failing to manufacture our products according to our specifications, quality regulations, including the FDA's Quality System regulations, or otherwise manufacturing products that we or regulatory authorities deem to be unsuitable for commercial use;
- risks associated with our contract manufacturer's ability to successfully undergo FDA and other regulatory authority quality inspections;
- potential uncertainty regarding manufacturing yields and costs;
- availability of manufacturing capability and capacity, particularly during periods of high demand;
- risks and uncertainties associated with the location or country where our products are manufactured, including potential manufacturing disruptions caused by social, geopolitical or environmental factors;
- changes in U.S. law or policy governing foreign trade, manufacturing, development and investment in the countries where we manufacture our products, including the World Trade Organization Information Technology Agreement or other free trade agreements;
- delays in delivery by suppliers due to customs clearing delays, shipping delays, scarcity of raw materials and changes in demand from us or their other customers;
- limited warranties provided to us; and
- potential misappropriation of our intellectual property.

These and other risks could impair our ability to fulfill orders, harm our sales and impact our reputation with customers. If our contract manufacturer is unable or unwilling to manufacture our products or components of our products, or if our contract manufacturer discontinues operations, we may be required to identify and qualify alternative manufacturers, which could cause us to be unable to meet our supply requirements to our customers and result in the breach of our customer agreements. The process of qualifying a new contract manufacturer and commencing volume production is expensive and time-consuming, and if we are required to change or qualify a new contract manufacturer, we would likely lose sales revenue and damage our existing customer relationships.

Failure to maintain or obtain new private payor contracts and future reductions in reimbursement rates from private payors could have a material adverse effect on our financial condition and results of operations.

A portion of our rental revenue is derived from private payors. Based on our patient population, we estimate approximately 40% of potential customers have non-Medicare insurance coverage (including Medicare Advantage plans). Failing to maintain and obtain private payor contracts from private insurance companies and employers and secure in-network provider status could have a material adverse effect on our financial condition and results of operations. In addition, private payors are under pressure to increase profitability and reduce costs. In response, certain private payors are limiting coverage or reducing reimbursement rates for the products we provide. We believe that private payor reimbursement levels will generally be reset in accordance with the Medicare reimbursement amounts determined by competitive bidding. We cannot predict the extent to which reimbursement for our products will be affected by competitive bidding or by initiatives to reduce costs for private payors. Failure to maintain or obtain new private payor contracts or the unavailability of third-party coverage or inadequacy of reimbursement for our products would adversely affect our business, financial condition and results of operations.

If we are unable to manage our anticipated growth effectively, our business could be harmed.

We have previously experienced periods of rapid growth in short periods of time. These periods of rapid growth of our business have placed a significant strain on our managerial and operational resources and systems. For example, as our business has grown, we have seen the cost per generated lead trend higher than historical averages. In addition, many of the sales representatives we hired in 2018 were unable to meet sales targets and were thus transitioned out To continue to grow our business, we must attract and retain capable personnel and manage and train them effectively, particularly related to sales representatives and supporting sales personnel. We must also upgrade our internal business processes and capabilities to create the scalability that a growing business demands. Going forward, we plan to begin to hire additional sales representatives at a more controlled pace across all three facilities to expand sales capacity, but we expect sales representative headcount to be down significantly at year-end 2019 compared to year-end 2018. Given the reduced sales representative headcount, we expect to realize headwinds to growth in direct-to-consumer sales in 2019. We believe we are making the necessary changes to improve sales management infrastructure to support sales representative training and onboarding and have made key changes to management personnel. We believe we will see increased productivity of our sales representatives throughout 2019, however we also expect increased marketing spend.

We plan to continue the expansion of our facilities located in Richardson, Texas and Goleta, California. Domestic expansion, combined with our use of a contract manufacturer in Europe to produce a portion of our Inogen One G3 concentrators, is expected to be sufficient to meet our manufacturing needs. However, our anticipated growth will place additional strain on our supply chain and manufacturing facilities, resulting in an increased need for us to carefully monitor parts inventory, capable staffing and quality assurance. Any failure by us to manage the scalability of our process or other aspects of our growth effectively could have an adverse effect on our ability to achieve our development and commercialization goals and negatively affect our financial condition and results of operations.

We may expand through acquisitions of, or investments in, other companies, each of which may divert our management's attention, result in additional dilution to our stockholders, increase expenses, disrupt our operations, and harm our results of operations.

Our business strategy may, from time to time, include acquiring or investing in complementary services, technologies or businesses, such as our acquisition of MedSupport Systems B.V. in 2017 and our planned acquisition of New Aera, which is expected to close in August 2019. We do not have an extensive history of acquiring other companies and cannot assure you that we will successfully identify suitable acquisition candidates, integrate or manage disparate technologies, lines of business, personnel and corporate cultures, realize our business strategy or the expected return on our investment, or manage a geographically dispersed company. Any such acquisition or investment could materially and adversely affect our financial condition and results of operations. We may issue equity securities which could dilute current stockholders' ownership, incur debt, assume contingent or other liabilities and expend cash in acquisitions, which could negatively impact our financial condition, stockholder equity, and stock price. We expect to complete our acquisition of New Aera in August 2019 and will then begin the integration process. The acquisition and integration process is complex, expensive and time-consuming, and may cause an interruption of, or loss of momentum in, product development and sales activities and operations of both companies, and we may incur substantial cost and expense, as well as divert the attention of management.

Acquisitions and other strategic investments involve significant risks and uncertainties, including:

- the potential failure to achieve the expected benefits of the combination or acquisition;
- unanticipated costs and liabilities;
- difficulties in integrating new products, businesses, operations, and technology infrastructure in an efficient and effective manner;
- difficulties in maintaining customer relations;
- the potential loss of key employees of the acquired businesses;
- the diversion of the attention of our senior management from the operation of our daily business;
- the potential adverse effect on our cash position to the extent that we use cash for the purchase price;
- the potential incurrence of interest expense and debt service requirements if we incur debt to pay for an acquisition;
- the potential issuance of securities that would dilute our stockholders' percentage ownership;

- the potential to incur large and immediate write-offs and restructuring and other related expenses;
- the potential of amortization expenses related to intangible assets;
- the potential to become involved in intellectual property litigation related to such acquisitions or strategic investments; and
- the inability to maintain uniform standards, controls, policies, and procedures.

Any acquisition or investment, including our acquisition of New Aera, could expose us to unknown liabilities. Moreover, we cannot assure you that we will realize the anticipated benefits of any acquisition or investment. In addition, our inability to successfully operate and integrate newly acquired businesses appropriately, effectively, and in a timely manner could impair our ability to take advantage of future growth opportunities and other advances in technology, as well as on our revenues, gross margins, and expenses.

As part of our ongoing efforts to advance patient preference and maintain our technology leadership position, we entered into a definitive agreement to acquire New Aera in August 2019. The transaction is expected to close in August 2019. We have made certain assumptions relating to the acquisition, which assumptions may be inaccurate, including as the result of any delay in closing the transaction, the failure to realize the expected benefits of the acquisition, failure to realize expected revenue, higher than expected operating, transaction and integration costs, as well as general economic and business conditions that adversely affect the combined company following the acquisition. If our assumptions relating to the acquisition are inaccurate, we may not be able to realize anticipated synergies and opportunities as a result of the acquisition, and the business may not perform as planned as a result of many of the risks and uncertainties that apply to the acquisition and to the rest of our business. For example, additional risks and uncertainties that could cause actual results to differ materially from currently anticipated results include, but are not limited to, the risk that the transaction is delayed or does not close; risks relating to our ability to successfully integrate New Aera's business and operations within our existing business and operations; our ability to commercialize the TAV; market acceptance of the TAV; our ability to successfully incorporate TAV into our existing products; competition; our sales, marketing and distribution capabilities; our planned sales, marketing, and research and development activities; interruptions or delays in the supply of components or materials for, or manufacturing of, our products, which in certain cases are purchased through sole and single source suppliers; seasonal variations in customer operations; unanticipated increases in costs or expenses; risks associated with international operations; intellectual property risks and the other risks identified in this Quarterly Report on Form 10-Q. We may also encounter difficulties in integrating New Aera into our existing business. If anticipated synergies and opportunities are not realized, our business, operating results and financial condition would be harmed.

We may experience manufacturing problems or delays that could limit our growth or adversely affect our operating results

Our Inogen One systems and Inogen At Home systems are manufactured using complex parts and processes, sophisticated equipment and strict adherence to design specifications and quality standards. Any unforeseen manufacturing problems, such as contamination of our facility, equipment malfunction or miscalibration, supply chain shortages, regulatory findings, or failure to strictly follow procedures or meet design specifications, could result in delays or shortfalls in production of our products. Identifying and resolving the cause of any such manufacturing issues could require substantial time and resources. If we are unable to keep up with demand for our products by successfully manufacturing and shipping our products in a timely and quality manner, our operating results could be impaired, market acceptance for our products could be adversely affected and our customers might instead purchase our competitors' products. For example, in July 2019 we initiated a software change for approximately eight thousand Inogen One G3 and OxyGo products in the field that were manufactured in the second quarter of 2019 due to an operating condition that may cause an abrupt shut down of the product from an over-draw that may occur when a fully charged 8-cell battery is connected to the portable oxygen concentrator as its only power source, which may cause the portable oxygen concentrator to become unresponsive for up to one minute, after which it will behave as though a battery was just connected with standard flash screen on display. If powered on again, this cycle may need to be repeated until the 8-cell battery has been adequately discharged allowing the product to operate as normal. Units remain in working order, and the product and battery are in no way being damaged or their performance compromised even with repeated cycling. In addition, the recently released Inogen One G5 system had a part on the motherboard that was not released via design controls and caused a higher incidence rate of component failures on approximately three thousand systems. We are replacing or field servicing all affected units (Inogen One G3, OxyGo, and Inogen One G5) which may increase our cost of goods sold and adversely affect our operating results and also harm our reputation. Additionally, regulators may disagree with our handling of this incident and take action. Also, although we believe we are addressing these issues, we may experience additional unexpected product defects or errors that could have adverse effects.

In addition, the introduction of new products may require the development of new manufacturing processes and procedures. While all of our products are assembled using essentially the same basic processes, significant changes in technology, programming, and other variations may be required to meet product specifications. Developing new processes can be very time consuming and affect quality, as such any unexpected difficulty in doing so could delay the introduction of a new product and our ability to produce sufficient quantities of existing products.

We are exposed to the credit and non-payment risk of our HME providers, distributors, private label partners and resellers, especially during times of economic uncertainty and tight credit markets, which could result in material losses.

We sell our products to certain HME providers, distributors, private label partner and resellers on unsecured credit, with terms that vary depending upon the customer's credit history, solvency, cash flow, credit limits and sales history, as well as prevailing terms with similarly situated customers and whether sufficient credit insurance can be obtained. In particular, two customers represented more than 10% of the Company's net accounts receivable balance with accounts receivable balances of $19.0 million and $6.2 million, respectively, as of June 30, 2019, and $16.2 million and $4.2 million, respectively, as of December 31, 2018. Challenging economic conditions may impair the ability of our customers to pay for products they have purchased, and as a result, our reserve for doubtful accounts could increase and, even if increased, may turn out to be insufficient. Moreover, even in cases where we have insolvency risk insurance to protect against a customer's bankruptcy, insolvency or liquidation, this insurance typically contains a significant deductible and co-payment obligation and does not cover all instances of non-payment. Our exposure to credit risks of our business partners may increase if our business partners and their end customers are adversely affected by global or regional economic conditions. One or more of these business partners could delay payments or default on credit extended to them, either of which could adversely affect our business, financial condition and results of operations.

We generate a substantial portion of our revenue internationally and are subject to various risks relating to such international activities, which could adversely affect our operating results. In addition, any disruption or delay in the shipping of our products, whether domestically or internationally, may have an adverse effect on our financial condition and results of operations.

During the six months ended June 30, 2019 and June 30, 2018, approximately 22.2% and 21.4%, respectively, of our total revenue was generated from customers located outside of the United States. We believe that a significant percentage of our future revenue will continue to come from international sources as we expand our international operations and develop opportunities in other countries. Engaging in international business inherently involves a number of difficulties and risks, including:

- required compliance with anti-bribery laws, such as the U.S. Foreign Corrupt Practices Act and U.K. Bribery Act, data privacy regulations, such as the European Union General Data Protection Regulation (GDPR), labor laws, and anti-competition regulations;
- export or import delays and restrictions;
- obtaining and maintaining regulatory clearances, approvals and certifications;
- laws and business practices favoring local companies;
- difficulties in enforcing agreements and collecting receivables through certain foreign legal systems;
- unstable economic, political, and regulatory conditions;
- supply chain complexities;
- fluctuations in currency exchange rates;
- potentially adverse tax consequences, tariffs, customs charges, bureaucratic requirements, and other trade barriers; and
- difficulties protecting or procuring intellectual property rights.

If one or more of these risks occurs, it could require us to dedicate significant resources to remedy, and if we are unsuccessful in finding a solution, our financial condition and results of operations will suffer.

In addition, on June 23, 2016, the United Kingdom (U.K.) held a referendum in which voters approved an exit from the European Union, commonly referred to as "Brexit." In February 2017, the British Parliament voted in favor of allowing the British government to begin the formal process of Brexit and discussions with the European Union began in March 2017. Adverse consequences concerning Brexit or the future of the European Union could include deterioration in global economic conditions, instability in global financial markets, political uncertainty, volatility in currency exchange rates or adverse changes in the cross-border agreements currently in place, any of which could have an adverse impact on our financial results in the future.

A significant amount of our international product sales are currently denominated in U.S. dollars and fluctuations in the value of the U.S. dollar relative to foreign currencies could decrease demand for our products and adversely impact our financial performance. For example, if the value of the U.S. dollar increases relative to foreign currencies, our products could become more costly to the international consumer and therefore less competitive in international markets. Our results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. We have experienced and will continue to experience fluctuations in our net income or

loss as a result of transaction gains or losses related to revaluing certain current asset and current liability balances that are denominated in currencies other than the functional currency of the entities in which they are recorded. For example, for the six months ended June 30, 2019, we experienced a net foreign currency gain of approximately $0.0 million, and for the six months ended June 30, 2018, we experienced a net foreign currency loss of $0.6 million. Fluctuations in currency exchange rates could have an adverse impact on our financial results in the future. While we have a hedging program for Euros that attempts to manage currency exchange rate risks to an acceptable level based on management's judgment of the appropriate trade-off between risk, opportunity, and cost, this hedging program does not completely eliminate the effects of currency exchange rate fluctuations. In addition, currency hedging may result in a reduction or increase in revenue should the currency strengthen or decline during the contract period. A discussion of the hedging program is contained in Item 7A, Quantitative and Qualitative Disclosures about Market Risk in our Annual Report on Form 10-K for the year ended December 31, 2018. Additional information on our hedging arrangements is also contained in Note 3 to the consolidated financial statements in this Quarterly Report on Form 10-Q.

We rely on shipping providers to deliver products to our customers globally. Labor, tariff, or World Trade Organization-related disputes, piracy, physical damage to shipping facilities or equipment caused by severe weather or terrorist incidents, congestion at shipping facilities, inadequate equipment to load, dock, and offload our products, energy-related tie-ups, or other factors could disrupt or delay shipping or offloading of our products domestically and internationally. Such disruptions or delays may have an adverse effect on our financial condition and results of operations.

Failure to comply with anti-bribery, anti-corruption, and anti-money laundering laws, including the U.S. Foreign Corrupt Practices Act of 1977, as amended, or the FCPA, and similar laws associated with our activities outside of the United States could subject us to penalties and other adverse consequences.

We are subject to the FCPA, the U.S. domestic bribery statute contained in 18 U.S.C. § 201, the U.S. Travel Act, the USA PATRIOT Act, the United Kingdom Bribery Act of 2010 and possibly other anti-corruption, anti-bribery and anti-money laundering laws in the more than forty countries around the world where we conduct activities and sell our products. We face significant risks and liability if we fail to comply with the FCPA and other anti-corruption and anti-bribery laws that prohibit companies and their employees and third-party business partners, such as distributors or resellers, from authorizing, offering or providing, directly or indirectly, improper payments or benefits to foreign government officials, political parties or candidates, employees of public international organizations including healthcare professionals, or private-sector recipients for the corrupt purpose of obtaining or retaining business, directing business to any person, or securing any advantage.

We leverage various third parties to sell our products and conduct our business abroad. We, our distributors and channel partners, and our other third-party intermediaries and manufacturer may have direct or indirect interactions with officials and employees of government agencies or state-owned or affiliated entities (such as in the context of obtaining government approvals, registrations, or licenses) and may be held liable for the corrupt or other illegal activities of these third-party business partners and intermediaries, our employees, representatives, contractors, partners, and agents, even if we do not explicitly authorize such activities. In many foreign countries, particularly in countries with developing economies, it may be a local custom that businesses engage in practices that are prohibited by the FCPA or other applicable laws and regulations. We provide training to all employees, including management, to ensure compliance with the FCPA. As such, we intend to continue to implement an FCPA/anti-corruption compliance program to ensure compliance with such laws but cannot assure you that all of our employees and agents, as well as those companies to which we outsource certain of our business operations, will not take actions in violation of our policies and applicable law, for which we have to defend ourselves and may be ultimately held responsible.

Any violation of the FCPA, other applicable anti-bribery, anti-corruption laws, and anti-money laundering laws could result in whistleblower complaints, adverse media coverage, investigations, loss of export privileges, severe criminal or civil sanctions and, in the case of the FCPA, suspension or debarment from U.S. government contracts, which could have a material and adverse effect on our reputation, business, operating results and prospects. In addition, responding to any enforcement action or related investigation may result in a materially significant diversion of management’s attention and resources and significant defense costs and other professional fees.

If we fail to comply with U.S. export control and economic sanctions or fail to expand and maintain an effective sales force or successfully develop our international distribution network, our business, financial condition and results of operations may be adversely affected.

We currently derive the majority of our revenue from rentals or sales generated from our own direct sales force. Failure to maintain or expand our direct sales force could adversely affect our financial condition and results of operations. Additionally, we use international distributors to augment our sales efforts, certain of which are exclusive distributors in certain foreign countries. We cannot assure you that we will be able to successfully retain or develop our relationships with third-party distributors internationally. In addition, we are subject to United States export control and economic sanctions laws relating to the sale of our products, the violation of which could result in substantial penalties being imposed against us. In particular, we have secured annual export licenses from the U.S. Treasury Department's Office of Foreign Assets Control to sell our products to a distributor and hospital and clinic end-users in Iran. The use of this license requires us to observe strict conditions with respect to products sold, end-user limitations and payment requirements. Although we believe we have maintained compliance with license requirements, there can be no assurance that the license will not be revoked, be renewed in the future or that we will remain in compliance. More broadly, if we fail to comply with export control laws or successfully develop our relationship with international distributors, our sales could fail to grow or could decline, and our ability to grow our business could be adversely affected. Distributors that are in the business of selling other medical products may not devote a sufficient level of resources and support required to generate awareness of our products and grow or maintain product sales. If our distributors are unwilling or unable to market and sell our products, or if they do not perform to our expectations, we could experience delayed or reduced market acceptance and sales of our products resulting in adverse results of operations.

We may be subject to substantial warranty or product liability claims or other litigation in the ordinary course of business that may adversely affect our business, financial condition and results of operations.

As manufacturers of medical devices, we may be subject to substantial warranty or product liability claims or other litigation in the ordinary course of business that may require us to make significant expenditures to defend these claims or pay damage awards. For example, our Inogen One systems contain lithium ion batteries, which, under certain circumstances, can be a fire hazard. We, as well as our key suppliers, maintain product liability insurance, but this insurance is limited in amount and subject to significant deductibles. There is no guarantee that insurance will be available or adequate to protect against all claims. Our insurance policies are subject to annual renewal and we may not be able to obtain liability or product insurance in the future on acceptable terms or at all. In addition, our insurance premiums could be subject to increases in the future, which may be material. If the coverage limits are inadequate to cover our liabilities or our insurance costs continue to increase as a result of warranty or product liability claims or other litigation, then our business, financial condition and results of operations may be adversely affected.

We may also be subject to other types of claims arising from our normal business activities. These may include claims, suits, and proceedings involving labor and employment, wage and hour, commercial, alleged securities laws violations or other investor claims, patent defense and other matters. The outcome of any litigation, regardless of its merits, is inherently uncertain. Any claims and lawsuits, and the disposition of such claims and lawsuits, could be time-consuming and expensive to resolve, divert management attention and resources, and lead to attempts on the part of other parties to pursue similar claims. Any adverse determination related to litigation could require us to change our technology or our business practices, pay monetary damages or enter into royalty or licensing arrangements, which could adversely affect our business, financial condition and results of operations.

Increases in our operating costs could have a material adverse effect on our business, financial condition and results of operations.

Reimbursement rates are established by fee schedules mandated by Medicare, private payors and Medicaid, and are likely to remain constant or decrease due, in part, to federal and state government budgetary constraints. As a result, with respect to Medicare and Medicaid related revenue, we are not able to offset the effects of general inflation on our operating costs through increases in prices for our products. In particular, labor and related costs account for a significant portion of our operating costs and we compete with other healthcare providers to attract and retain qualified or skilled personnel and with various industries for administrative and service employees. This competitive environment could result in increased labor costs. As such, we must control our operating costs, particularly labor and related costs and failing to do so could adversely affect our financial condition and results of operations.

We depend on the services of our senior executives and other key technical personnel, the loss of whom could negatively affect our business.

Our success depends upon the skills, experience and efforts of our senior executives and other key technical personnel, including certain members of our engineering, accounting and compliance staff as well as our sales and marketing personnel. Much of our corporate expertise is concentrated in relatively few employees, the loss of which for any reason could negatively affect our business. Competition for our highly skilled employees is intense and we cannot prevent the resignation of any employee. We do not maintain "key man" life insurance on any of our senior executives. None of our senior executive team is bound by written employment contracts to remain with us for a specified period. In addition, we have not entered into non-compete agreements with members of our executive management team. The loss of any member of our executive management team could harm our ability to implement our business strategy and respond to the market conditions in which we operate.

We and our vendors and service providers rely on information technology networks and systems, and if we are unable to protect against service interruptions, data corruption, cybersecurity risks, data security incidents and/or network security breaches, our operations could be disrupted and our business could be negatively affected.

We rely on information technology networks and systems to process, transmit and store electronic, customer, operational, compliance, and financial information; to coordinate our business; and to communicate within our company and with customers, suppliers, partners and other third-parties. These information technology networks and systems may be susceptible to damage, disruptions or shutdowns, hardware or software failures, power outages, computer viruses, cybersecurity risks, data security incidents, telecommunication failures, user errors or catastrophic events. Like other companies, we have experienced data security incidents before. For example, on April 13, 2018, we announced that messages within an employee email account were accessed by unknown persons outside of our company without authorization. Some of the messages and attached files in that email account contained personal information belonging to our rental customers. We immediately took steps to secure customer information and hired a leading forensics firm to investigate the incident and to bolster our security. The unauthorized access of the potentially impacted email account appears to have occurred between January 2, 2018 and March 14, 2018. We notified approximately 30,000 current and former rental customers of this incident as well as the applicable regulatory authorities. We also provided resources, including credit monitoring and an insurance reimbursement policy, to assist all potentially affected individuals. We have incurred remedial, legal and other costs in connection with this incident. We have insurance coverage in place for certain potential liabilities and costs relating to service interruptions, data corruption, cybersecurity risks, data security incidents and/or network security breaches, but this insurance is limited in amount, subject to a deductible, and may not be adequate to cover us for all costs arising from these incidents.

If our information technology networks and systems suffer unauthorized access, severe damage, disruption or shutdown, and our business does not effectively identify or resolve the issues in a timely manner, our operations could be disrupted, we could be subject to regulatory and consumer lawsuits and our business could be negatively affected. In addition, cybersecurity risks and data security incidents could lead to potential unauthorized access to or acquisition of confidential information (including protected health information), and data loss and corruption. There is no assurance that we will not experience service interruptions, security breaches, cyber security risks and data security incidents, or other information technology failures in the future.

The methods used to obtain unauthorized access, disable or degrade service or sabotage systems are constantly evolving and may be difficult to anticipate or to detect for long periods of time. As a result of these types of risks and attacks, we have implemented and periodically review and update systems, processes, and procedures to protect against unauthorized access to or use of data and to prevent data loss. For example, we have recently increased the security of our systems by requiring all email users to change their passwords following our recent data security incident and sooner than they would have otherwise been required to. We also implemented multi-factor authentication for remote email access and have taken additional steps to further limit access to our systems. However, the ever-evolving threats mean we and our third-party service providers and vendors must continually evaluate and adapt our respective systems and processes and overall security environment. There is no guarantee that these measures will be adequate to safeguard against all data security breaches, system compromises or misuses of data.

The compromise of our technology systems resulting in the loss, disclosure, misappropriation of, or access to, customers', employees' or business partners' information or failure to comply with regulatory or contractual obligations with respect to such information could result in legal claims or proceedings, liability or regulatory penalties under laws protecting the privacy of personal information, disruption to our operations and damage to our reputation, any or all of which could adversely affect our business. The costs to remediate breaches and similar system compromises that do occur could adversely affect our results of operations.

In addition, we must comply with increasingly complex and rigorous regulatory standards enacted to protect business and personal data in the U.S., Europe and elsewhere. For example, the European Union adopted the GDPR, which became effective on May 25, 2018. TheGDPR imposes additional obligations on companies regarding the processing of personal data and provides certain individual privacy rights to natural persons whose data is stored. Compliance with existing, proposed and recently enacted laws (including implementation of the privacy and process enhancements called for under the GDPR) and regulations can be costly and any failure to comply with these regulatory standards could subject us to legal and reputational risks. Misuse of or failure to secure or properly process personal information could also result in violation of data privacy laws and regulations, proceedings against the Company by governmental entities or others, damage to our reputation and credibility and could have a negative impact on revenues and profits. As the regulatory environment related to information security, data collection and use, and privacy becomes increasingly rigorous, with new and constantly changing requirements applicable to our business, compliance with those requirements could continue to result in significant costs.

Our financial condition and results of operations may vary significantly from quarter-to-quarter due to a number of factors, which may lead to volatility in our stock price.

Our quarterly revenue and results of operations have varied in the past and may continue to vary significantly from quarter-to-quarter. This variability may lead to volatility in our stock price as research analysts and investors respond to these quarterly fluctuations. These fluctuations are due to numerous factors, including: fluctuations in consumer demand for our products; seasonal cycles in consumer spending; HME providers' ability to adopt and finance portable oxygen concentrator purchases and restructure their businesses to remove delivery expenses; our ability to design, manufacture and deliver products to our consumers in a timely and cost-effective manner; quality control problems in our manufacturing operations; our ability to timely obtain adequate quantities of the components used in our products; new product introductions and enhancements by us and our competitors; unanticipated increases in costs or expenses; declines in sales personnel productivity; increased marketing cost per generated lead; unanticipated regulatory reimbursement changes that could result in positive or negative impacts to our earnings; changes or updates to generally accepted accounting principles; and fluctuations in foreign currency exchange rates. As more HME providers adopt portable oxygen concentrators in their businesses, we expect that this could change our historical seasonality in the domestic business-to-business channel as well, which was previously influenced mainly by consumer buying patterns. The foregoing factors are difficult to forecast, and these, as well as other factors, could materially and adversely affect our quarterly and annual results of operations. We have experienced significant revenue growth in the past, but we may not achieve similar growth rates, profit margins and/or net income in future periods. You should not rely on our operating results for any prior quarterly or annual period as an indication of our future operating performance. If we are unable to maintain adequate revenue growth and cost control, our operating results could suffer, and our stock price could decline. In addition, a significant amount of our operating expenses are relatively fixed due to our manufacturing, research and development and sales and general administrative efforts. Any failure to adjust spending quickly enough to compensate for a revenue shortfall could magnify the adverse impact of such revenue shortfall on our results of operations. Our results of operations may not meet the expectations of research analysts or investors, in which case the price of our common stock could decrease significantly.

Given our levels of stock-based compensation, our tax rate may vary significantly depending on our stock price.

The tax effects of the accounting for share-based compensation may significantly impact our effective tax rate from period to period. In periods in which our stock price is higher than the grant price of the stock-based compensation vesting in that period, we will recognize excess tax benefits that will decrease our effective tax rate. For example, in the six months ended June 30, 2019 excess tax benefits recognized from stock-based compensation decreased our provision for income taxes by $0.4 million and our effective tax rate by 2.3% as compared to the tax rate without such benefits. However, in periods in which our stock price may be lower than the grant price of the stock-based compensation vesting in that period, our effective tax rate may increase. For example, in the three months ended June 30, 2019 excess tax deficiencies recognized from stock-based compensation increased our tax rate by $0.2 million and our effective tax rate by 1.4% as compared to the tax rate without such deficiencies. The amount and value of stock-based compensation issued relative to our earnings in a particular period will also affect the magnitude of the impact of stock-based compensation on our effective tax rate. These tax effects are dependent on our stock price and employee stock option exercises, which we do not control, and a decline in our stock price could significantly increase our effective tax rate and adversely affect our results of operations.

If the market opportunities for our products are smaller than we believe they are, our revenues may be adversely affected and our business may suffer.

Our projections regarding (i) the size of the oxygen therapy market, both in the United States and internationally, (ii) the size and percentage of the long-term oxygen therapy market that is subject to competitive bidding in the United States, (iii) the number of oxygen therapy patients, (iv) the number of patients requiring ambulatory and stationary oxygen, (v) the number of patients who rely on the delivery model, (vi) the percentage of the long-term oxygen therapy market serviced by Medicare, Medicare Advantage, and other third party-payors, (vii) the size of the retail long-term oxygen therapy market and how the opportunity may change as portable oxygen concentrator penetration increases, and (viii) the share of portable oxygen concentrators as a percentage of the total oxygen therapy spend are based on estimates that we believe are reliable. These estimates may prove to be incorrect, new data or studies may change the estimated incidence or prevalence of patients requiring long-term oxygen therapy, or the type of long-term oxygen therapy patients. The number of patients in the United States and internationally may turn out to be lower than expected, patients may not be otherwise amenable to treatment with our products, or new patients may become increasingly difficult to identify or gain access to, all of which would adversely affect our results of operations and our business.

An adverse outcome of a sales and use tax audit could have a material adverse effect on our results of operations and financial condition.

The California State Board of Equalization conducted a sales and use tax audit of our operations in California in 2008. As a result of the audit, the California State Board of Equalization confirmed that our sales are not subject to California sales and use tax. We believe that our sales in three states may be subject to sales and use tax, but in other states they should be exempt from sales and use tax. There can be no assurance, however, that other states may agree with our position and we may be subject to an audit that may not be resolved in our favor. Such an audit could be expensive and time-consuming and result in substantial management distraction. If the matter were to be resolved in a manner adverse to us, it could have a material adverse effect on our results of operations and financial condition.

Changes in accounting principles, or interpretations thereof, could have a significant effect on our financial condition and results of operations.

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, referred to as U.S. GAAP. These principles are subject to interpretation by the Securities and Exchange Commission (SEC) and various bodies formed to interpret and create appropriate accounting principles. A change in these principles can have a significant effect on our reported results and may even retroactively affect previously reported transactions. Additionally, the adoption of new or revised accounting principles may require that we make significant changes to our systems, processes and controls.

For example, the U.S.-based Financial Accounting Standards Board, referred to as FASB, is currently working together with the International Accounting Standards Board, referred to as IASB, on several projects to further align accounting principles and facilitate more comparable financial reporting between companies who are required to follow U.S. GAAP under SEC regulations and those who are required to follow International Financial Reporting Standards outside of the United States. These efforts by the FASB and IASB may result in different accounting principles under U.S. GAAP that may result in materially different financial results for us in areas including, but not limited to, principles for recognizing revenue and lease accounting. Additionally, significant changes to U.S. GAAP resulting from the FASB's and IASB's efforts may require that we change how we process, analyze and report financial information and that we change financial reporting controls.

It is not clear if or when these potential changes in accounting principles may become effective, whether we have the proper systems and controls in place to accommodate such changes and the impact that any such changes may have on our financial condition and results of operations.

Our ability to use net operating losses to offset future taxable income may be subject to certain limitations.

Utilization of our net operating losses and tax credit carryforwards may be subject to annual limitations arising from ownership change limitations imposed by the Internal Revenue Code and similar state provisions. Such annual limitations could result in the expiration of our net operating losses and tax credit carryforwards before their utilization.

Changes in tax laws or tax rulings could materially affect our financial condition, results of operations, and cash flows.

The income and non-income tax regimes we are subject to or operate under are unsettled and may be subject to significant change. Changes in tax law or tax rulings, or changes in interpretations of existing law, could adversely affect our financial condition and results of operations. For example, changes to the U.S. tax laws enacted in December 2017 had a significant impact on our deferred tax assets, income tax provision and effective tax rate for the year ended December 31, 2017. In addition, many countries in Europe, as well as a number of other countries and organizations, have recently proposed or recommended changes to existing tax laws or have enacted new laws that could significantly increase our tax obligations in many countries where we do business or require us to change the manner in which we operate our business.

Risks related to the regulatory environment

We are subject to extensive federal and state regulation, and if we fail to comply with applicable regulations, we could suffer severe criminal or civil sanctions and be required to make significant changes to our operations that could adversely affect our business, financial condition and results of operations.

The federal government and all states in which we currently operate regulate various aspects of our business. In particular, our operations are subject to state laws governing, among other things, distribution of medical equipment and certain types of home health activities, and we are required to obtain and maintain licenses in many states to act as a durable medical equipment supplier. Certain of our employees are subject to state laws and regulations governing the professional practices of respiratory therapy.

As a healthcare provider participating in governmental healthcare programs, we are subject to laws directed at preventing fraud and abuse, which subject our marketing, billing, documentation and other practices to strict government scrutiny. To ensure compliance with Medicare, Medicaid and other regulations, government agencies or their contractors often conduct routine audits and request customer records and other documents to support our claims submitted for payment of services rendered. Government agencies or their contractors also periodically open investigations and obtain information from healthcare providers. Violations of federal and state regulations can result in severe criminal, civil and administrative fines, penalties and sanctions, including debarment, suspension or exclusion from Medicare, Medicaid and other government reimbursement programs, any of which would have a material adverse effect on our business.

Changes in healthcare laws and regulations and new interpretations of existing laws and regulations may affect permissible activities, the relative costs associated with doing business, and reimbursement amounts paid by federal, state and other third-party payors. There have been and will continue to be regulatory initiatives affecting our business and we cannot predict the extent to which future legislation and regulatory changes could have a material adverse effect on our business.

We are subject to significant regulation by numerous government agencies, including the U.S. Food and Drug Administration, or FDA. We cannot market or commercially distribute our products without obtaining and maintaining necessary regulatory clearances or approvals.

Our Inogen concentrators are medical devices subject to extensive regulation in the United States and in the foreign markets where we distribute our products. The FDA and other U.S. and foreign governmental agencies regulate, among other things, with respect to medical devices:

- design, development and manufacturing;
- testing, labeling, content and language of instructions for use and storage;
- clinical trials;
- product safety;
- marketing, sales and distribution;
- pre-market clearance and approval;
- record keeping;
- advertising and promotion;
- recalls and field safety corrective actions;

- post-market surveillance, including reporting of deaths or serious injuries and malfunctions that, if they were to recur, could lead to death or serious injury;
- post-market approval studies; and
- product import and export.

Before we can market or sell a medical device in the United States, we must obtain either clearance from the FDA under Section 510(k) of the Federal Food, Drug, and Cosmetic Act, or the FDCA, or approval of a pre-market approval application from the FDA, unless an exemption applies. In the 510(k) clearance process, the FDA must determine that a proposed device is "substantially equivalent" to a device legally on the market, known as a "predicate" device, with respect to intended use, technology and safety and effectiveness, in order to clear the proposed device for marketing.

Our commercial products have received 510(k) clearance by the FDA. If the FDA requires us to go through a lengthier, more rigorous examination for future products or modifications to existing products than we had expected, our product introductions or modifications could be delayed or canceled, which could cause our sales to decline. In addition, the FDA may determine that future products will require the more costly, lengthy and uncertain pre-market approval process. Although we do not currently market any devices under a pre-market approval, the FDA may demand that we obtain a pre-market approval prior to marketing certain future products. In addition, if the FDA disagrees with our determination that a product we currently market is subject to an exemption from pre-market review, the FDA may require us to submit a 510(k) or pre-market approval application in order to continue marketing the product. Further, even with respect to those future products where a pre-market approval is not required, we cannot assure you that we will be able to obtain the 510(k) clearances with respect to those products or do so in a timely fashion.

The FDA can delay, limit or deny clearance or approval of a device for many reasons, including:

- we may not be able to demonstrate to the FDA's satisfaction that our products are safe and effective for their intended uses;
- the data from our pre-clinical studies and clinical trials may be insufficient to support clearance or approval, where required; and
- the manufacturing process or facilities we use may not meet applicable Quality System Regulations.

Medical devices may only be promoted and sold for the indications for which they are approved or cleared. In addition, even if the FDA has approved or cleared a product, it can take action affecting such product approvals or clearances if serious safety or other problems develop in the marketplace. Delays in obtaining clearances or approvals could adversely affect our ability to introduce new products or modifications to our existing products in a timely manner, which would delay or prevent commercial sales of our products. Additionally, the FDA and other regulatory authorities have broad enforcement powers. Regulatory enforcement or inquiries, or other increased scrutiny on us, could affect the perceived safety and performance of our products and dissuade our customers from using our products.

If we modify our FDA cleared devices, we may need to seek additional clearances or approvals, which, if not granted, would prevent us from selling our modified products.

Any modification we make to our Inogen One systems and Inogen At Home systems that could significantly affect their safety or effectiveness, or would constitute a major change in intended use, manufacture, design, materials, labeling, or technology requires the submission and clearance of a new 510(k) pre-market notification or, possibly, pre-market approval. The FDA requires every manufacturer to make this determination in the first instance, but the FDA may review and disagree with any manufacturer's decision. The FDA may not agree with our decisions regarding whether new clearances or approvals are necessary. We have modified some of our 510(k) cleared products and have determined that in certain instances new 510(k) clearances or pre-market approval are not required. If the FDA disagrees with our determination and requires us to submit new 510(k) notifications or pre-market approval for modifications to our previously cleared products for which we have concluded that new clearances or approvals are unnecessary, we may be required to cease marketing or to recall the modified product until we obtain clearance or approval, and we may be subject to significant regulatory fines or penalties.

If we fail to comply with FDA or state regulatory requirements, we can be subject to enforcement action.

Even after we have obtained regulatory clearance or approval to market a product, we have ongoing responsibilities under FDA regulations. The FDA and state authorities have broad enforcement powers. Our failure to comply with applicable regulatory requirements could result in enforcement action by the FDA or state agencies, which may include any of the following sanctions:

- adverse publicity, warning letters, fines, injunctions, consent decrees and civil penalties;
- recalls, termination of distribution, or seizure of our products;
- operating restrictions or partial suspension or total shutdown of production;
- delays in the introduction of products into the market;
- refusal to grant our requests for future 510(k) clearances or approvals of new products, new intended uses, or modifications to exiting products;
- withdrawals or suspensions of current 510(k) clearances or approvals, resulting in prohibitions on sales of our products; and
- criminal prosecution.

Any of these sanctions could result in higher than anticipated costs or lower than anticipated sales and have a material adverse effect on our reputation, business, results of operations and financial condition.

A recall of our products, either voluntarily or at the direction of the FDA or another governmental authority, or the discovery of serious safety issues with our products that leads to corrective actions, could have a significant adverse effect on us.

The FDA and similar foreign governmental authorities have the authority to require the recall of commercialized products in the event of material deficiencies or defects in design, labeling or manufacture of a product or in the event that a product poses an unacceptable risk to health. Manufacturers may also, under their own initiative, recall a product if any material deficiency in a device is found or withdraw a product to improve device performance or for other reasons. Similar regulatory agencies in other countries have similar authority to recall devices because of material deficiencies or defects in design or manufacture that could endanger health. A government-mandated or voluntary recall by us or one of our distributors could occur as a result of an unacceptable risk to health, component failures, manufacturing errors, design or labeling defects or other deficiencies and issues. Any recall would divert management attention and financial resources, could cause the price of our stock to decline and expose us to product liability or other claims and harm our reputation with customers. A recall involving our Inogen concentrators could be particularly harmful to our business, financial condition and results of operations.

We are required to timely report to the FDA any incident in which our product may have caused or contributed to a death or serious injury or in which our product malfunctioned and, if the malfunction were to recur, would likely cause or contribute to death or serious injury. Repeated product malfunctions may result in a voluntary or involuntary product recall. Depending on the corrective action we take to redress a product's deficiencies or defects, the FDA may require, or we may decide, that we will need to obtain new approvals or clearances for the device before we may market or distribute the corrected device. Seeking such approvals or clearances may delay our ability to replace the recalled devices in a timely manner. Moreover, if we do not adequately address problems associated with our devices, we may face additional regulatory enforcement action, including adverse publicity, FDA warning letters, product seizure, injunctions, administrative penalties, or civil or criminal fines. We may also be required to bear other costs or take other actions that may have a negative impact on our sales as well as face significant adverse publicity or regulatory consequences, which could harm our business, including our ability to market our products in the future.

Any adverse event involving our products, whether in the United States or abroad, could result in future voluntary corrective actions, such as recalls or customer notifications, or agency action, such as inspection, mandatory recall or other enforcement action. Any corrective action, whether voluntary or involuntary, as well as defending ourselves in a lawsuit, will require the dedication of our time and capital, distract management from operating our business and may harm our reputation and results of operations.

If we, our contract manufacturer, or our component manufacturers fail to comply with the FDA's Quality System Regulation, our manufacturing operations could be interrupted, and our product sales and operating results could suffer.

We, our contract manufacturer, and our component manufacturers are required to comply with the FDA's Quality System Regulation, or QSR, which covers the procedures and documentation of the design, calibration, testing, production, control, quality assurance, labeling, packaging, storage and shipping of our devices. The FDA audits compliance with the QSR through periodic announced and unannounced inspections of manufacturing and other facilities. We and our component manufacturers have been, and anticipate in the future being, subject to such inspections. Although we believe our manufacturing facilities and those of our

component manufacturers are in compliance with the QSR, we cannot provide assurance that any future inspection will not result in adverse findings. If we fail to implement timely and appropriate corrective actions that are acceptable to the FDA or if our other manufacturing facilities or those of any of our component manufacturers, contract manufacturers, or suppliers are found to be in violation of applicable laws and regulations, or we or our manufacturers or suppliers fail to take prompt and satisfactory corrective action in response to an adverse inspection, the FDA could take enforcement action, including any of the following sanctions:

- adverse publicity, untitled letters, warning letters, fines, injunctions, consent decrees and civil penalties;
- customer notifications or repair, replacement, refunds, recall, detention or seizure of our products;
- operating restrictions or partial suspension or total shutdown of production;
- refusing or delaying our requests for 510(k) clearance or pre-market approval of new products or modified products;
- withdrawing 510(k) clearances or pre-market approvals that have already been granted;
- refusal to grant export approval for our products; or
- criminal prosecution.

Any of these sanctions could adversely affect our business, financial condition and results of operations.

Outside the United States, our products and operations are also often required to comply with standards set by industrial standards bodies, such as the International Organization for Standardization, or ISO. Foreign regulatory bodies may evaluate our products or the testing that our products undergo against these standards. The specific standards, types of evaluation and scope of review differ among foreign regulatory bodies. If we fail to adequately comply with any of these standards, a foreign regulatory body may take adverse actions similar to those within the power of the FDA. Any such action may harm our reputation and could have an adverse effect on our business, results of operations and financial condition.

The primary regulatory body in Europe is the European Commission, which includes most of the major countries in Europe. The European Commission has adopted numerous directives and standards regulating the design, manufacture, clinical trial, labeling and adverse event reporting for medical devices. Devices that comply with the requirements of a relevant directive will be entitled to bear the CE conformity marking, indicating that the device conforms to the essential requirements of the applicable directives and, accordingly, can be commercially distributed throughout Europe. The method of assessing conformity varies depending on the class of the product, but normally involves a combination of self-assessment by the manufacturer and a third-party assessment by a "Notified Body." An assessment by a Notified Body of one country within the European Union is required in order for a manufacturer to commercially distribute the product throughout the European Union.

If we fail to obtain and maintain regulatory approval in foreign jurisdictions, our market opportunities will be limited.

Approximately 22.3% and 21.3% of our total revenue was from sales outside of the United States for the three months ended June 30, 2019 and June 30, 2018, respectively, and 22.2% and 21.4% for the six months ended June 30, 2019 and June 30, 2018, respectively. We sell our products in 46 countries outside of the United States through our wholly owned subsidiary, distributors or directly to large "house" accounts. In order to market our products in the European Union or other foreign jurisdictions, we must obtain and maintain separate regulatory approvals and comply with numerous and varying regulatory requirements. The approval procedure varies from country to country and can involve additional product testing. The time required to obtain approval abroad may be longer than the time required to obtain FDA clearance. The foreign regulatory approval process includes many of the risks associated with obtaining FDA clearance and we may not obtain foreign regulatory approvals on a timely basis, if at all. FDA clearance does not ensure approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other foreign countries. However, the failure to obtain clearance or approval in one jurisdiction may have a negative impact on our ability to obtain clearance or approval elsewhere. If we do not obtain or maintain necessary approvals to commercialize our products in markets outside the United States, we may be required to discontinue sales in those countries which would negatively affect our overall market penetration, revenues, results of operations and financial condition.

We are subject to burdensome and complex billing and record-keeping requirements in order to substantiate our claims for payment under federal, state and commercial healthcare reimbursement programs, and our failure to comply with existing requirements, or changes in those requirements or interpretations thereof, could adversely affect our business, financial condition and results of operations.

We are subject to burdensome and complex billing and record-keeping requirements in order to substantiate our claims for payment under federal, state and commercial healthcare reimbursement programs. Our records also are subject to routine and other reviews by third-party payors, which can result in delays in payments or refunds of paid claims. We could experience a significant increase in pre-payment reviews of our claims by the Durable Medical Equipment Medicare Administrative Contractors, which could cause substantial delays in the collection of our Medicare accounts receivable as well as related amounts due under supplemental insurance plans.

Current law provides for a significant expansion of the government's auditing and oversight of suppliers who care for patients covered by various government healthcare programs. Examples of this expansion include audit programs being implemented by the Durable Medical Equipment Medicare Administrative Contractors, the Zone Program Integrity Contractors, the Recovery Audit Contractors, and the Comprehensive Error Rate Testing contractors, operating under the direction of CMS, and the various state Medicaid Fraud Control Units.

We have been informed by these auditors that healthcare providers and suppliers of certain durable medical equipment product categories are expected to experience further increased scrutiny from these audit programs. When a government auditor ascribes a high billing error rate to one or more of our locations, it generally results in protracted pre-payment claims review, payment delays, refunds and other payments to the government and/or our need to request more documentation from providers than has historically been required. It may also result in additional audit activity in other company locations in that state or Durable Medical Equipment Medicare Administrative Contractors jurisdiction. We cannot currently predict the adverse impact that these audits, methodologies and interpretations might have on our business, financial condition or results of operations, but such impact could be material.

We may be subject to fines, penalties or injunctions if we are determined to be promoting the use of our products for unapproved or "off-label" uses, resulting in damage to our reputation and business.

Our promotional materials and training methods must comply with the FDA and other applicable laws and regulations, including the prohibition of the promotion of a medical device for a use that has not been cleared or approved by the FDA. Physicians may use our products off-label, as the FDA does not restrict or regulate a physician's choice of treatment within the practice of medicine. If the FDA determines that our promotional materials or training constitutes promotion of an off-label use that is either false or misleading, it could request that we modify our training or promotional materials or subject us to regulatory or enforcement actions, which could have an adverse effect on our reputation and results of operations.

Failure to comply with the Federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, the Health Information Technology for Economic and Clinical Health Act, or HITECH Act, and implementing regulations could result in significant penalties.

Numerous federal and state laws and regulations, including HIPAA and the HITECH Act, govern the collection, dissemination, security, use and confidentiality of patient-identifiable health information. HIPAA and the HITECH Act require us to comply with standards for the use and disclosure of protected health information within our company and with third parties. The Privacy Standards and Security Standards under HIPAA establish a set of basic national privacy and security standards for the protection of individually identifiable health information by health plans, healthcare clearinghouses and certain healthcare providers, referred to as covered entities, and the business associates with whom such covered entities contract for services. Notably, whereas HIPAA previously directly regulated only these covered entities, the HITECH Act, which was signed into law as part of the stimulus package in February 2009, makes certain of HIPAA's privacy and security standards also directly applicable to covered entities' business associates. As a result, both covered entities and business associates are now subject to significant civil and criminal penalties for failure to comply with Privacy Standards and Security Standards.

HIPAA requires healthcare providers like us to develop and maintain policies and procedures with respect to protected health information that is used or disclosed, including the adoption of administrative, physical and technical safeguards to protect such information from unauthorized disclosure. The HITECH Act expands the notification requirement for breaches of patient-identifiable health information, restricts certain disclosures and sales of patient-identifiable health information and provides a tiered system for civil monetary penalties for HIPAA violations. The HITECH Act also increased the civil and criminal penalties that may be imposed against covered entities, business associates and possibly other persons and gave state attorneys general new authority to file civil actions for damages or injunctions in federal courts to enforce the federal HIPAA laws and seek attorney fees and costs associated with pursuing federal civil actions. Additionally, certain states have adopted comparable privacy and security laws and regulations, some of which may be more stringent than HIPAA.

If we are determined to be out of compliance with existing or new laws and regulations related to patient health information, we could be subject to criminal or civil sanctions. New health information standards, whether implemented pursuant to HIPAA, the HITECH Act, congressional action or otherwise, could have a significant effect on the manner in which we handle healthcare related data and communicate with payors, and the cost of complying with these standards could be significant.

The 2013 final HITECH omnibus rule modifies the breach reporting standard in a manner that will likely make more data security incidents qualify as reportable breaches. Any liability from a failure to comply with the requirements of HIPAA or the HITECH Act could adversely affect our results of operations and financial condition. The costs of complying with privacy and security related legal and regulatory requirements are burdensome and could have a material adverse effect on our results of operations.

Regulations requiring the use of "standard transactions" for healthcare services issued under HIPAA may negatively affect our profitability and cash flows.

Pursuant to HIPAA, final regulations have been implemented to improve the efficiency and effectiveness of the healthcare system by facilitating the electronic exchange of information in certain financial and administrative transactions while protecting the privacy and security of the information exchanged.

The HIPAA transaction standards are complex, and subject to differences in interpretation by third-party payors. For instance, some third-party payors may interpret the standards to require us to provide certain types of information, including demographic information not usually provided to us by physicians. As a result of inconsistent application of transaction standards by third-party payors or our inability to obtain certain billing information not usually provided to us by physicians, we could face increased costs and complexity, a temporary disruption in accounts receivable and ongoing reductions in reimbursements and net revenue. In addition, requirements for additional standard transactions, such as claims attachments or use of a national provider identifier, could prove technically difficult, time-consuming or expensive to implement, all of which could harm our business.

If we fail to comply with state and federal fraud and abuse laws, including anti-kickback, Stark, false claims and anti-inducement laws, we could face substantial penalties and our business, results of operations and financial condition could be adversely affected.

The Federal Anti-Kickback Statute prohibits, among other things, knowingly and willfully offering, paying, soliciting or receiving remuneration to induce or in return for purchasing, leasing, ordering, or arranging for the purchase, lease or order of any healthcare item or service reimbursable under Medicare, Medicaid, or other federal healthcare programs. Although there are a number of statutory exceptions and regulatory safe harbors protecting certain common activities from prosecution, the exceptions and safe harbors are drawn narrowly, and any remuneration to or from a prescriber or purchaser of healthcare products or services may be subject to scrutiny if it does not qualify for an exception or safe harbor. Our practices may not in all cases meet all of the criteria for safe harbor protection from anti-kickback liability. Failure to meet all requirements of a safe harbor is not determinative of a kickback issue but could subject the practice to increased scrutiny by the government.

The "Stark Law" prohibits a physician from referring Medicare or Medicaid patients to an entity providing "designated health services," which includes durable medical equipment, if the physician or immediate family member of the physician, has an ownership or investment interest in or compensation arrangement with such entity that does not comply with the requirements of a Stark exception. Violation of the Stark Law could result in denial of payment, disgorgement of reimbursements received under a non-compliant arrangement, civil penalties, and exclusion from Medicare, Medicaid or other governmental programs. Although we believe that we have structured our provider arrangements to comply with current Stark Law requirements, these arrangements may not expressly meet the requirements for applicable exceptions from the law.

Federal false claims laws prohibit any person from knowingly presenting or causing to be presented a false claim for payment to the federal government, or knowingly making or causing to be made a false statement to get a false claim paid. The majority of states also have statutes or regulations similar to the federal anti-kickback and self-referral laws and false claims laws, which apply to items or services, reimbursed under Medicaid and other state programs, or, in several states, apply regardless of payor. These false claims statutes allow any person to bring suit in the name of the government alleging false and fraudulent claims presented to or paid by the government (or other violations of the statutes) and to share in any amounts paid by the entity to the government in fines or settlement. Such suits, known as *qui tam* actions, have increased significantly in the healthcare industry in recent years. Sanctions under these federal and state laws may include civil monetary penalties, exclusion of a manufacturer's products from reimbursement under government programs, criminal fines and imprisonment. In addition, the recently enacted Patient Protection and Affordable Care Act, among other things, amends the intent requirement of the federal anti-kickback and criminal healthcare fraud statutes. A person or entity no longer needs to have actual knowledge of this statute or specific intent to violate it. In addition, the Patient Protection and Affordable Care Act provides that the government may assert that a claim including items or services resulting from a violation of the federal anti-kickback statute constitutes a false or fraudulent claim for purposes of the false claims statutes. Because of the breadth of these laws and the narrowness of the safe harbors and exceptions, it is possible that some of our business activities could be subject to challenge under one or more of such laws. Such a challenge, regardless of the outcome, could have a material adverse effect on our business, business relationships, reputation, financial condition and results of operations.

The Patient Protection and Affordable Care Act also imposes annual reporting and disclosure requirements on device and drug manufacturers for "transfers of value" made or distributed to licensed physicians and teaching hospitals. Device and drug manufacturers are also required to report and disclose annually any investment interests held by physicians and their immediate family members during the preceding calendar year. Failure to submit required information may result in civil monetary penalties of up to an aggregate of $0.17 million per year (and up to an aggregate of $1.128 million per year for "knowing failures"), for all payments, transfers of value or ownership or investment interests not reported in an annual submission.

In addition, there has been a recent trend of increased federal and state regulation of payments made to physicians. Certain states, mandate implementation of compliance programs and/or the tracking and reporting of gifts, compensation and other remuneration to physicians. The shifting compliance environment and the need to build and maintain robust and expandable systems to comply with different compliance and/or reporting requirements in multiple jurisdictions increase the possibility that a healthcare company many violate one or more of the requirements.

The Federal Civil Monetary Penalties Law prohibits the offering or giving of remuneration to a Medicare or Medicaid beneficiary that the person knows or should know is likely to influence the beneficiary's selection of a particular supplier of items or services reimbursable by a Federal or state governmental healthcare program. We sometimes offer customers various discounts and other financial incentives in connection with the sales of our products. While it is our intent to comply with all applicable laws, the government may find that our marketing activities violate the Civil Monetary Penalties Law. If we are found to be in non-compliance, we could be subject to civil money penalties of up to $0.02 million for each wrongful act, assessment of three times the amount claimed for each item or service and exclusion from the federal or state healthcare programs.

On February 3, 2017, the Department of Justice (DOJ) published a final rule that applies an inflation adjustment to civil monetary penalty (CMP) amounts, as mandated by the Bipartisan Budget Act of 2015. The maximum CMP for False Claims Act violations is $0.02 million for civil penalties assessed after August 1, 2016 and whose violations occurred after November 2, 2015.

The Bipartisan Budget Act of 2018 increases the CMP and criminal fines and sentences for various fraud and abuse violations under the Medicare and Medicaid programs for violations committed after February 9, 2018. The new maximum CMP for a False Claims Act violation is $0.02 million.

The scope and enforcement of each of these laws is uncertain and subject to rapid change in the current environment of healthcare reform, especially in light of the lack of applicable precedent and regulations. If our operations are found to be in violation of any of the laws described above or any other government regulations that apply to us, we may be subject to penalties, including civil and criminal penalties, damages, fines and the curtailment or restricting of our operations. Any penalties, damages, fines, curtailment or restructuring or our operations could harm our ability to operate our business and our results of operations. Any action against us for violation of these laws, even if we successfully defend against it, could cause us to incur significant legal expenses and divert our management's attention from operation of our business. Moreover, achieving and sustaining compliance with applicable federal and state fraud laws may prove costly.

Foreign governments tend to impose strict price controls, which may adversely affect our future profitability.

We sell our products in 46 countries outside the United States through our wholly owned subsidiary, distributors or directly to large "house" accounts. In some foreign countries, particularly in the European Union, the pricing of medical devices is subject to governmental control. In these countries, pricing negotiations with governmental authorities can take considerable time after the receipt of marketing approval for a product. To obtain reimbursement or pricing approval in some countries, we may be required to supply data that compares the cost-effectiveness of our Inogen One and Inogen At Home systems to other available oxygen therapies. If reimbursement of our products is unavailable or limited in scope or amount, or if pricing is set at unsatisfactory levels, it may not be profitable to sell our products in certain foreign countries, which would negatively affect the long-term growth of our business.

Our business activities involve the use of hazardous materials, which require compliance with environmental and occupational safety laws regulating the use of such materials. If we violate these laws, we could be subject to significant fines, liabilities or other adverse consequences.

Our research and development programs as well as our manufacturing operations involve the controlled use of hazardous materials. Accordingly, we are subject to international, federal, state and local laws governing the use, handling and disposal of these materials. Although we believe that our safety procedures for handling and disposing of these materials comply in all material respects with the standards prescribed by state and federal regulations of each country in which we conduct business, we cannot completely eliminate the risk of accidental contamination or injury from these materials. In the event of an accident or failure to comply with environmental laws, we could be held liable for resulting damages, and any such liability could exceed our insurance coverage and adversely affect our financial condition and results of operations.

New regulatory requirements under Proposition 65 could adversely affect our business.

We are subject to California's Proposition 65, or Prop 65, which requires a specific warning on any product that contains a substance listed by the State of California as having been found to cause cancer or birth defects, unless the level of such substance in the product is below a safe harbor level. Prop 65 required that all businesses must be in compliance by August 30, 2018 with new regulations that require modifications to product warnings and for businesses to coordinate with upstream vendors or downstream customers for the 800+ regulated chemicals in consumer products and assess whether new occupational exposure warnings need to be posited in California facilities. We have taken steps to add warning labels to our products packaged in California and manufactured after August 30, 2018. Although we cannot predict the ultimate impact of these new requirements, they could reduce overall consumption of our products or leave consumers with the perception (whether or not valid) that our products do not meet their health and wellness needs, all of which could adversely affect our business, financial condition andresults of operations.

Risks related to our intellectual property

If we are unable to secure and maintain patent or other intellectual property protection for the intellectual property used in our products, we will lose a significant competitive advantage, which may adversely affect our future profitability.

Our commercial success depends, in part, on obtaining, defending, and maintaining patent and other intellectual property protection for the technologies used in our products. The patent positions of medical device companies, including ours, can be highly uncertain and involve complex and evolving legal and factual questions. Furthermore, we might in the future opt to license intellectual property from other parties. If we, or the other parties from whom we would license intellectual property, fail to obtain, defend, and maintain adequate patent or other intellectual property protection for intellectual property used in our products, or if any protection is reduced or eliminated, others could use the intellectual property used in our products, resulting in harm to our competitive business position. In addition, patent and other intellectual property protection may not:

- prevent our competitors from duplicating our products;
- prevent our competitors from gaining access to our proprietary information and technology;
- prevent our competitors or other parties from suing us for alleged infringement; or
- permit us to gain or maintain a competitive advantage.

Any of our patents may be challenged, invalidated, circumvented or rendered unenforceable. We cannot provide assurance that we will be successful should one or more of our patents be challenged for any reason. If our patent claims are rendered invalid or unenforceable, or narrowed in scope, the patent coverage afforded our products could be impaired, which could make our products less competitive.

As of June 30, 2019, we have ten pending patent applications and one pending international patent application, thirty-three issued patents relating to the design and construction of our oxygen concentrators and our intelligent delivery technology. We cannot specify which of these patents individually or as a group will permit us to gain or maintain a competitive advantage. Patents may be subject to reexamination, *inter partes* review, post-grant review, and derivation proceedings in the U.S. Patent and Trademark Office or comparable proceedings in other patent offices worldwide. Foreign patents may be subject to opposition or comparable proceedings in the corresponding foreign patent offices. Any of these proceedings could result in loss of the patent or denial of the patent application, or loss or reduction in the scope of one or more of the claims of the patent or patent application. Changes in either patent laws or in interpretations of patent laws may also diminish the value of our intellectual property or narrow the scope of our protection. Interference, reexamination, *inter partes* review, defense, opposition and derivation proceedings may be costly and time consuming, and we, or the other parties from whom we might potentially license intellectual property, may be unsuccessful in defending against such proceedings. Thus, any patents that we own or might license may provide limited or no protection against competitors. In addition, our pending patent applications and those we may file in the future may have claims narrowed during prosecution or may not result in patents being issued. Even if any of our pending or future applications are issued, they may not provide us with any competitive advantage or adequate protection from allegations of infringement, whether valid or frivolous, which may result in the incurrence of material defense costs. Our patents and patent applications are directed to particular aspects of our products. Other parties may develop and obtain patent protection for more effective technologies, designs or methods for oxygen therapy. If these developments were to occur, it would likely have an adverse effect on our sales. Our ability to develop additional patentable technology is also uncertain.

Non-payment or delay in payment of patent fees or annuities, whether intentional or unintentional, may also result in the loss of patents or patent rights important to our business. Many countries, including certain countries in Europe, have compulsory licensing laws under which a patent owner may be compelled to grant licenses to other parties. In addition, many countries limit the enforceability of patents against other parties, including government agencies or government contractors. In these countries, the patent owner may have limited remedies, which could materially diminish the value of the patent. In addition, the laws of some foreign countries do not protect intellectual property rights to the same extent as do the laws of the United States, particularly in the field of medical products and procedures.

Our products could infringe or appear to infringe the intellectual property rights of others, which may lead to patent and other intellectual property litigation that could itself be costly, could result in the payment of substantial damages or royalties, prevent us from using technology that is essential to our products, and/or force us to discontinue selling our products.

The medical device industry in general has been characterized by extensive litigation and administrative proceedings regarding patents and other intellectual property rights. Our competitors hold a significant number of patents relating to oxygen therapy devices and products. Third parties have in the past asserted and may in the future assert that we are employing their proprietary technology without authorization. For example, Separation Design Group IP Holdings, LLC (SDGIP) filed a lawsuit against us on October 23, 2015 in the United States District Court for the Central District of California. SDGIP alleged that we willfully infringed U.S. Patent Nos. 8,894,751 and 9,199,055, both of which are titled "Ultra Rapid Cycle Portable Oxygen Concentrator." SDGIP also alleged misappropriation of trade secrets and breach of contract stemming from a meeting in September 2010. SDGIP sought to recover damages (including compensatory and treble damages), costs and expenses (including attorneys' fees), pre-judgment and post-judgment interest, and other relief that the Court deem proper. SDGIP also sought a permanent injunction against us. CAIRE, Inc. (CAIRE) filed a lawsuit against us in the United States District Court for the Northern District of Georgia on September 12, 2016. CAIRE alleged that we infringed U.S. Patent No. 6,949,133, entitled "Portable Oxygen Concentrator." While we settled our lawsuit with SDGIP in October 2017 and with CAIRE in December 2017, if we fail in defending against lawsuits or claims brought against us in the future, we could be subject to substantial monetary damages and injunctive relief, and we cannot predict the outcome of any lawsuit. For example, in connection with our recent acquisition of New Aera, a competitor or New Aera indicated that it believes New Aera has infringed its intellectual property rights and that it was considering filing a patent infringement lawsuit with respect to certain New Aera technology we acquired through the acquisition. An adverse determination or protracted defense costs of such lawsuits could have a material effect on our business and operating results.

From time to time, we have also commenced litigation to enforce our intellectual property rights. For example, we previously pursued litigation against Inova Labs, Inc. (a subsidiary of ResMed Corp.) for infringement of two of our patents seeking damages, injunctive relief, costs, and attorneys' fees. While we settled our lawsuit with Inova Labs in June 2016, an adverse decision in any other legal action could limit our ability to assert our intellectual property rights, limit the value of our technology or otherwise negatively affect our business, financial condition and results of operations.

Monitoring unauthorized use of our intellectual property is difficult and costly. Unauthorized use of our intellectual property may have occurred or may occur in the future. Although we have taken steps to minimize the risk of this occurring, any such failure to identify unauthorized use and otherwise adequately protect our intellectual property would adversely affect our business. Moreover, if we are required to commence litigation, whether as a plaintiff or defendant as has occurred with Inova Labs, SDGIP, and CAIRE, not only will this be time-consuming, but we will also be forced to incur significant costs and divert our attention and efforts of our employees, which could, in turn, result in lower revenue and higher expenses.

We cannot provide assurance that our products or methods do not infringe or appear to not infringe the patents or other intellectual property rights of third parties and if our business is successful, the possibility may increase that others will assert infringement claims against us whether valid or frivolous.

Determining whether a product infringes a patent involves complex legal and factual issues, defense costs and the outcome of a patent litigation action are often uncertain. We have not conducted an extensive search of patents issued or assigned to other parties, including our competitors, and no assurance can be given that patents containing claims covering or appearing to cover our products, parts of our products, technology or methods do not exist, have not been filed or could not be filed or issued. Because of the number of patents issued and patent applications filed in our technical areas, our competitors or other parties may assert that our products and the methods we employ in the use of our products are covered by U.S. or foreign patents held by them. In addition, because patent applications can take many years to issue and because publication schedules for pending applications may vary by jurisdiction and some patent applications may not be published in the U.S., there may be applications now pending of which we are unaware and which may result in issued patents that our current or future products infringe or appear to infringe. Also, because the claims of published patent applications can change between publication and patent grant, there may be published patent applications that may ultimately issue with claims that we infringe. There could also be existing patents that one or more of our products or parts may infringe and of which we are unaware. As the number of competitors in the market for oxygen products and the number of patents

issued in this area grows, the possibility of patent infringement claims against us increases. In certain situations, we may determine that it is in our best interests to voluntarily challenge a party's patents in litigation or other proceedings, including declaratory judgment actions, patent reexaminations, or *inter partes* reviews. As a result, we may become involved in unwanted protracted litigation that could be costly, result in diversion of management's attention, require us to pay damages and/or licensing royalties and force us to discontinue selling our products.

Infringement and other intellectual property claims and proceedings brought against us, whether successful or not, could result in substantial costs and harm to our reputation. Such claims and proceedings can also distract and divert management and key personnel from other tasks important to the success of the business. We cannot be certain that we will successfully defend against allegations of infringement of patents or other intellectual property rights. In the event that we become subject to a patent infringement or other intellectual property related lawsuit and if the asserted patents or other intellectual property were upheld as valid and enforceable and we were found to infringe the asserted patents or other intellectual property, or violate the terms of a license to which we are a party, we could be required to do one or more of the following:

- cease selling or using any of our products that incorporate the asserted intellectual property, which would adversely affect our revenue;
- pay damages for past use of the asserted intellectual property, which may be substantial;
- obtain a license from the holder of the asserted intellectual property, which license may not be available on reasonable royalty terms, if at all, and which could reduce profitability; and
- redesign or rename, in the case of trademark claims, our products to avoid infringing the intellectual property rights of third parties, which may not be possible and could be costly and time-consuming if it is possible to do so.

If we are unable to prevent unauthorized use or disclosure of trade secrets, unpatented know-how and other proprietary information, our ability to compete will be harmed.

We rely on a combination of trade secrets, copyrights, trademarks, confidentiality agreements and other contractual provisions and technical security measures to protect certain aspects of our technology, especially where we do not believe that patent protection is appropriate or obtainable. We require our employees and consultants to execute confidentiality agreements in connection with their employment or consulting relationships with us. We also require our employees and consultants to disclose and assign to us all inventions conceived during the term of their employment or engagement while using our property or that relate to our business. We also require our corporate partners, outside scientific collaborators and sponsored researchers, advisors and others with access to our confidential information to sign confidentiality agreements. We also have taken precautions to initiate reasonable safeguards to protect our information technology systems. However, these measures may not be adequate to safeguard our proprietary intellectual property and conflicts may, nonetheless, arise regarding ownership of inventions. Such conflicts may lead to the loss or impairment of our intellectual property or to expensive litigation to defend our rights against competitors who may be better funded and have superior resources. Our employees, consultants, contractors, outside clinical collaborators and other advisors may unintentionally or willfully disclose our confidential information to competitors. In addition, confidentiality agreements may be unenforceable or may not provide an adequate remedy in the event of unauthorized disclosure. Enforcing a claim that a third-party illegally obtained and is using our trade secrets is expensive and time-consuming, and the outcome is unpredictable. Moreover, our competitors may independently develop equivalent knowledge, methods and know-how. Unauthorized parties may also attempt to copy or reverse engineer certain aspects of our products that we consider proprietary, and in such cases we could not assert any trade secret rights against such party. As a result, other parties may be able to use our proprietary technology or information, and our ability to compete in the market would be harmed.

"Inogen," "Inogen One," "Inogen One G2," "Inogen One G3," "G4," "G5," "Oxygenation," "Live Life in Moments, not Minutes," "Never Run Out of Oxygen," "Oxygen Therapy on Your Terms," "Oxygen.Anytime.Anywhere," "Reclaim Your Independence," "Intelligent Delivery Technology," "Inogen At Home," and the Inogen design are registered trademarks with the United States Patent and Trademark Office of Inogen, Inc. We own trademark registrations for the mark "Inogen" in Australia, Canada, South Korea, Mexico, Europe (European Union registration), Japan, New Zealand, Turkey, and Singapore. We own pending applications for the mark "Inogen" in Argentina, Brazil, China, Colombia, Ecuador, Iceland, India, Israel, Norway, and Switzerland. We own a trademark registration for the mark "□□□□□" in Japan. We own trademark applications for the marks "□□□" and "□□□" in China. We own trademark registrations for the mark "Inogen One" in Australia, Canada, China, South Korea, Mexico, and Europe (European Union registration). We own a trademark registration for the mark "Satellite Conserver" in Canada. We own a trademark registration for the mark "Inogen At Home" in Europe (European Union Registration). We own trademark registrations for the mark "G4" in Europe (European Union registration) and the United Kingdom. We own trademark applications for the Inogen design in Bolivia and China. Other service marks, trademarks, and trade names referred to in this Quarterly Report on Form 10-Q are the property of their respective owners.

We may be subject to damages resulting from claims that our employees, agents or we have wrongfully used or disclosed alleged trade secrets of other companies.

Some of our employees and consultants, including employees who are expected to be joining us following our planned acquisition of New Aera, were previously employed by or contracted with other medical device companies focused on the development of oxygen therapy products, including our competitors. We may be subject to claims that these employees or agents have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. If we fail in defending such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights. Even if we are successful in defending against these claims, litigation could result in substantial costs, damage to our reputation and be a distraction to management.

Risks related to being a public company

We will incur increased costs as a result of operating as a public company and our management will be required to devote substantial time to new compliance initiatives and corporate governance practices.

As a public company, especially now that we are no longer an "emerging growth company," we will continue to incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act of 2002 and rules enforced by the Public Companies Oversight Board (PCAOB) subsequently implemented by the SEC and the NASDAQ Global Select Market impose numerous requirements on public companies, including establishment and maintenance of effective disclosure and financial controls and corporate governance practices. Also, the Securities Exchange Act of 1934, as amended, or the Exchange Act, requires, among other things, that we file annual, quarterly and current reports with respect to our business and operating results. Our management and other personnel will need to devote a substantial amount of time to compliance with these laws and regulations. These requirements have increased and will continue to increase our legal, accounting, external audit and financial compliance costs and have made and will continue to make some activities more time consuming and costly. For example, we expect these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to incur substantial costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors or our board committees or as executive officers.

Overall, we estimate that our incremental costs resulting from operating as a public company, including compliance with these rules and regulations, may be between $1.5 million and $3.0 million per year. However, these rules and regulations are often subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies and public accounting firms are subject to PCAOB compliance audits. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices.

The Sarbanes-Oxley Act requires, among other things, that we assess and document the effectiveness of our internal control over financial reporting annually and the effectiveness of our disclosure controls and procedures quarterly. In particular, Section 404(a) of the Sarbanes-Oxley Act, or Section 404(a), requires us to perform system and process evaluation and testing of our internal control over financial reporting to allow management to report on the effectiveness of our internal control over financial reporting. Section 404(b) of Sarbanes-Oxley Act, or Section 404(b), also requires our independent registered public accounting firm to attest to the effectiveness of our internal control over financial reporting. Now that we are no longer an "emerging growth company," our independent registered public accounting firm is required to undertake an assessment of our internal control over financial reporting, and the cost of our compliance with Section 404(b) is higher. Our compliance with applicable provisions of Section 404 will require that we incur substantial accounting expense and expend significant management time on compliance-related issues as we implement additional corporate governance practices and comply with reporting requirements.

Furthermore, investor perceptions of our company may suffer if deficiencies are found, and this could cause a decline in the market price of our stock. Irrespective of compliance with Section 404, any failure of our internal control over financial reporting could have a material adverse effect on our stated operating results and harm our reputation. If we are unable to implement these requirements effectively or efficiently, it could harm our operations, financial reporting, or financial results and could result in an adverse opinion on our internal controls from our independent registered public accounting firm.

Failure to maintain effective internal controls could cause our investors to lose confidence in us and adversely affect the market price of our common stock. If our internal controls are not effective, we may not be able to accurately report our financial results or prevent fraud.

Section 404 of the Sarbanes-Oxley Act, or Section 404, requires that we maintain internal control over financial reporting that meets applicable standards. We may err in the design, operation or documentation of our controls, and all internal control systems, no matter how well designed and operated, can provide only reasonable assurance that the objectives of the control system are met. Because there are inherent limitations in all control systems, there can be no absolute assurance that all control issues have been or will be detected. If we are unable, or are perceived as unable, to produce reliable financial reports due to internal control deficiencies, investors could lose confidence in our reported financial information and operating results, which could result in a negative market reaction.

We are required to disclose significant changes made in our internal controls and procedures on a quarterly basis. Now that we are no longer an "emerging growth company," our independent registered public accounting firm is also required to attest to the effectiveness of our internal control over financial reporting pursuant to Section 404. Our independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our controls are documented, designed or operating. Our remediation efforts may not enable us to avoid a material weakness in the future. Additionally, to comply with the requirements of being a public company, we may need to undertake various actions, such as implementing new internal controls and procedures and hiring accounting or internal audit staff, which may adversely affect our results of operations and financial condition.

Although prior material weaknesses have been remediated, we cannot assure you that our internal controls will continue to operate properly or that our financial statements will be free from error. There may be undetected material weaknesses in our internal control over financial reporting, as a result of which we may not detect financial statement errors on a timely basis. Moreover, in the future we may implement new offerings and engage in business transactions, such as acquisitions, reorganizations or implementation of new information systems that could require us to develop and implement new controls and could negatively affect our internal control over financial reporting and result in material weaknesses.

If we identify new material weaknesses in our internal control over financial reporting, if we are unable to comply with the requirements of Section 404 in a timely manner, if we are unable to assert that our internal controls over financial reporting are effective, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal control over financial reporting, we may be late with the filing of our periodic reports, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock could be negatively affected. As a result of such failures, we could also become subject to investigations by the stock exchange on which our securities are listed, the SEC, or other regulatory authorities, and become subject to litigation from investors and stockholders, which could harm our reputation, financial condition or divert financial and management resources from our core business.

Risks related to our common stock

We expect that our stock price will fluctuate significantly, you may have difficulty selling your shares, and you could lose all or part of your investment.

Our stock is currently traded on NASDAQ, but we can provide no assurance that we will be able to maintain an active trading market on NASDAQ or any other exchange in the future. If an active trading market does not develop, you may have difficulty selling any of our shares of common stock that you buy. In addition, the trading price of our common stock may be highly volatile and could be subject to wide fluctuations in response to various factors, some of which are beyond our control. These factors include:

- actual or anticipated quarterly variation in our results of operations or the results of our competitors;
- announcements of secondary offerings;
- announcements by us or our competitors of new commercial products, significant contracts, commercial relationships or capital commitments;
- issuance of new or changed securities analysts' reports or recommendations for our stock;
- developments or disputes concerning our intellectual property or other proprietary rights;
- commencement of, or our involvement in, litigation;
- market conditions in the oxygen therapy market;
- reimbursement or legislative changes in the oxygen therapy market;

- failure to complete significant sales;
- manufacturing disruptions that could occur if we were unable to successfully expand our production in our current or an alternative facility;
- any future sales of our common stock or other securities;
- any major change to the composition of our board of directors or management;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- the other factors described in this "Risk Factors" section; and
- general economic conditions and slow or negative growth of our markets.

The stock market in general and market prices for the securities of technology-based companies like ours in particular, have from time to time experienced volatility that often has been unrelated to the operating performance of the underlying companies. These broad market and industry fluctuations may adversely affect the market price of our common stock, regardless of our operating performance. In several recent situations where the market price of a stock has been volatile, holders of that stock have instituted securities class action litigation against the company that issued the stock.

Stockholder litigation has been filed against us in the past, and a class action securities lawsuit against us is currently pending, as discussed in the "Legal Proceedings" section of this Quarterly Report on Form 10-Q. While we are continuing to defend such actions vigorously, the defense of such actions can be costly, divert the time and attention of our management and harm our operating results, and any judgment against us or any future stockholder litigation could result in substantial costs.

If securities or industry analysts do not publish research or publish unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock will rely in part on the research and reports that equity research analysts publish about us and our business. We will not have any control of the analysts or the content and opinions included in their reports. The price of our stock could decline if one or more equity research analysts downgrade our stock or issue other unfavorable commentary or research. If one or more equity research analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which in turn could cause our stock price or trading volume to decline.

Future sales of shares could cause our stock price to decline.

Our stock price could decline as a result of sales of a large number of shares of our common stock or the perception that these sales could occur. These sales, or the possibility that these sales may occur, also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

As of June 30, 2019, one holder of approximately 3.5 million shares, or approximately 16.2%, of our outstanding shares, has rights, subject to some conditions, to require us to file registration statements covering the sale of their shares or to include their shares in registration statements that we may file for ourselves or other stockholders. We have also registered the offer and sale of all shares of common stock that we may issue under our equity compensation plans.

In addition, in the future, we may issue additional shares of common stock or other equity or debt securities convertible into common stock in connection with a financing, acquisition, litigation settlement, and employee arrangements or otherwise. Any such issuance could result in substantial dilution to our existing stockholders and could cause our stock price to decline.

Our directors, executive officers and principal stockholders will continue to have substantial control over us and could limit your ability to influence the outcome of key transactions, including changes of control.

As of June 30, 2019, our executive officers, directors and stockholders who owned more than 5% of our outstanding common stock and their respective affiliates beneficially owned or controlled approximately 61.0% of the outstanding shares of our common stock. Accordingly, these executive officers, directors and stockholders who owned more than 5% of our outstanding common stock and their respective affiliates, acting as a group, have substantial influence over the outcome of corporate actions requiring stockholder approval, including the election of directors, any merger, consolidation or sale of all or substantially all of our assets or any other significant corporate transactions. These stockholders may also delay or prevent a change of control of us, even if such a change of control would benefit our other stockholders. The significant concentration of stock ownership may adversely affect the trading price of our common stock due to investors' perception that conflicts of interest may exist or arise.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management and limit the market price of our common stock.

Provisions in our certificate of incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our management. Our amended and restated certificate of incorporation and amended and restated bylaws include provisions that:

- authorize our board of directors to issue, without further action by the stockholders, up to 10,000,000 shares of undesignated preferred stock;
- require that any action to be taken by our stockholders be affected at a duly called annual or special meeting and not by written consent;
- specify that special meetings of our stockholders can be called only by our board of directors, the Chairman of the board of directors, or the Chief Executive Officer;
- establish an advance notice procedure for stockholder approvals to be brought before an annual meeting of our stockholders, including proposed nominations of persons for election to our board of directors;
- establish that our board of directors is divided into three classes, Class I, Class II and Class III, with each class serving staggered three-year terms;
- provide that our directors may be removed only for cause;
- provide that vacancies on our board of directors may be filled only by a majority of directors then in office, even though less than a quorum;
- specify that no stockholder is permitted to cumulate votes at any election of directors; and
- require a super-majority of votes to amend certain of the above-mentioned provisions.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of stockholders owning in excess of 15% of our outstanding voting stock to merge or combine with us.

We have never paid dividends on our capital stock, and we do not anticipate paying any cash dividends in the foreseeable future.

We have paid no cash dividends on any of our classes of capital stock to date and currently intend to retain our future earnings to fund the development and growth of our business. In addition, we may become subject to covenants under future debt arrangements that place restrictions on our ability to pay dividends. As a result, capital appreciation, if any, of our common stock is expected to be your sole source of gain for the foreseeable future.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Unregistered Sales of Equity Securities

None.

Issuer Purchases of Equity Securities

We did not repurchase any shares of our common stock during the three months or six months ended June 30, 2019 and June 30, 2018.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description	Incorporated by Reference From Form	Incorporated by Reference From Exhibit Number	Date Filed
10.1	Lease Agreement, dated June 19, 2019, by and between the Company, and RAF Pacifica Group – Real Estate Fund IV, LLC, APG Hollywood Center, LLC, and APG Airport Freeway Center, LLC	Filed herewith		
31.1	Certification Pursuant to Exchange Act Rules 13a - 14(a) and 15d - 14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Chief Executive Officer	Filed herewith		
31.2	Certification Pursuant to Exchange Act Rules 13a - 14(a) and 15d - 14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Chief Financial Officer	Filed herewith		
32.1(1)	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Chief Executive Officer			
32.2(1)	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Chief Financial Officer			
101.INS	XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.			
101.SCH	XBRL Taxonomy Extension Schema Document			
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document			
101.LAB	XBRL Taxonomy Extension Label Linkbase Document			
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document			
101.DEF	XBRL Taxonomy Extension Definition Document			
104	The cover page of this Quarterly Report on Form 10-Q, formatted in inline XBRL.			

(1) The Certifications attached as Exhibits 32.1 and 32.2 that accompany this Quarterly Report on Form 10-Q are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Inogen, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INOGEN, INC.

Dated: August 7, 2019

By: /s/ Scott Wilkinson
Scott Wilkinson
Chief Executive Officer
President
Director
(Principal Executive Officer)

Dated: August 7, 2019

By: /s/ Alison Bauerlein
Alison Bauerlein
Chief Financial Officer
Executive Vice President, Finance
Secretary and Treasurer
(Principal Financial and Accounting Officer)

AIRCRE

STANDARD INDUSTRIAL/COMMERCIAL SINGLE-TENANT LEASE - NET

1. Basic Provisions ("Basic Provisions").

1.1 **Parties.** This Lease ("**Lease**"), dated for reference purposes only June 19, 2019, is made by and between Raf Pacifica Group - Real Estate Fund IV, LLC, a California limited liability company; APG Hollywood Center, LLC, a California limited liability company; and APG Airport Freeway Center, LLC, a California limited liability company (collectively, "**Lessor**") and INOGEN, INC., a Delaware corporation ("**Lessee**"), (collectively the "**Parties**," or individually a "**Party**").

1.2 **Premises:** That certain real property, including all improvements therein or to be provided by Lessor under the terms of this Lease, commonly known as (street address, city, state, zip): 301 Coromar Drive, Goleta, CA ("**Premises**"). The Premises are located in the County of Santa Barbara, and are generally described as (describe briefly the nature of the property and, if applicable, the "**Project**," if the property is located within a Project): a two-story office/industrial building (to be constructed) consisting of approximately 49,821 rentable square feet on an approximately 3.12 acre lot known as Lot 9. The Project consists of a business park with an area of approximately 20 acres known as the Cabrillo Business Park. (See also Paragraph 2)

1.3 **Term:** Ten (10) years and two (2) months ("**Original Term**") commencing November 1, 2020 ("**Commencement Date**") and ending December 31, 2030 ("**Expiration Date**"). (See also Paragraph 3 and 55)

1.4 **Early Possession:** If the Premises are available Lessee may have non-exclusive possession of the Premises commencing upon substantial completion of Base Building and Tenant Improvements ("**Early Possession Date**"). (See also Paragraphs 3.2 and 3.3 and Work Letter Section 4.1)

1.5 **Base Rent:** $94,659.90 per month ("**Base Rent**"), payable on the first day of each month commencing on the Commencement Date. (See also Paragraph 4)

☒ If this box is checked, there are provisions in this Lease for the Base Rent to be adjusted. See Paragraph 51.

1.6 **Base Rent and Other Monies Paid** within five (5) business days after full **Execution** (except as set forth below)**:**

(a) **Base Rent:** $94,659.90 for the period First full calendar month of the term, payable thirty (30) days before the Commencement Date.

(b) **Security Deposit:** $119,529.90 ("**Security Deposit**"). (See also Paragraph 5)

(c) **Association Fees**: --- for the period.

(d) **Other:** $24,870.00 for Operating Expenses for the first full calendar month of the Term, payable thirty (30) days before the Commencement Date.

(e) **Total Due Upon Execution of this Lease:** $119,529.90.

1.7 **Agreed Use**: General office space, research and development, light manufacturing and assembly, and warehousing. (See also Paragraph 6)

1.8 **Insuring Party.** Lessor is the "**Insuring Party**" unless otherwise stated herein. (See also Paragraph 8)

1.9 **Real Estate Brokers.** (See also Paragraph 15 and 25)

(a) **Representation**: Each Party acknowledges receiving a Disclosure Regarding Real Estate Agency Relationship, confirms and consents to the following agency relationships in this Lease with the following real estate brokers ("Broker(s)") and/or their agents ("Agent(s)"):

Lessor's Brokerage Firm: Hayes Commercial Group
License No.: 02017017
Is the broker of (check one):
☐ the Lessor; or ☒ both the Lessee and Lessor (dual agent).
Lessor's Agent: Christos Celmayster
License No.: 01342996
Is (check one):
☒ the Lessor's Agent (salesperson or broker associate); or ☐ both the Lessee's Agent and the Lessor's Agent (dual agent).
Lessee's Brokerage Firm: CBRE
License No.: 00409987
Is the broker of (check one):
☒ the Lessee; or ☐ both the Lessee and Lessor (dual agent).
Lessee's Agent: Francois DeJohn/Dennis J. Hearst
License No.: 01144570/800238
Is (check one):
☒ the Lessee's Agent (salesperson or broker associate); or ☐ both the Lessee's Agent and the Lessor's Agent (dual agent).

(b) **Payment to Brokers:** (See Paragraph 68.)

1.10 **Guarantor.** The obligations of the Lessee under this Lease are to be guaranteed by N/A ("**Guarantor**"). (See also Paragraph 37)

1.11 **Attachments.** Attached hereto are the following, all of which constitute a part of this Lease:

☒ an Addendum consisting of Paragraphs 53 through 71;
☐ a plot plan depicting the Premises;
☐ a current set of the Rules and Regulations;
☒ a Work Letter (Exhibit B);
☒ other (specify): Site plan depicting the Premises and the Project (Exhibit A); Plans for Base Building Improvements (Exhibit A-1); Declaration of CC&R's (Exhibit C); Site plan with Additional Parking on Lot 14 (Exhibit D); Rent Adjustment (Paragraph 51); Option(s) to Extend (Paragraph 52).

2. Premises.

2.1 **Letting**. Lessor hereby leases to Lessee, and Lessee hereby leases from Lessor, the Premises, for the term, at the rental, and upon all of the terms, covenants and conditions set forth in this Lease. While the approximate square footage of the Premises may have been used in the marketing of the Premises for purposes of comparison, the Base Rent stated herein is NOT tied to square footage and is not subject to adjustment should the actual size be determined to be different. **NOTE: Lessee is advised to verify the actual size prior to executing this Lease.** (See also Paragraphs 56 and 57.)

2.2 **Condition**. Lessor shall deliver the Premises to Lessee broom clean and free of debris on the Commencement Date or the Early Possession Date, whichever first occurs ("**Start Date**"), and, so long as the required service contracts described in Paragraph 7.1(b) below are obtained by Lessee and in effect within thirty days following the Start Date, warrants that the existing electrical, plumbing, fire sprinkler, lighting, heating, ventilating and air conditioning systems ("**HVAC**"), loading doors, sump pumps, if any, and all other such elements in the Premises, other than those constructed by Lessee, shall be in good operating condition on said date, that the structural elements of the roof, bearing walls and foundation of any buildings on the Premises (the "**Building**") shall be free of

material defects, and that the Premises do not contain hazardous levels of any mold or fungi defined as toxic under applicable state or federal law. If a non-compliance with said warranty exists as of the Start Date, or if one of such systems or elements should malfunction or fail within the appropriate warranty period, Lessor shall, as Lessor's sole obligation with respect to such matter, except as otherwise provided in this Lease, promptly after receipt of written notice from Lessee setting forth with specificity the nature and extent of such non-compliance, malfunction or failure, rectify same at Lessor's expense. The warranty periods shall be as follows: (i) 12 months as to the HVAC systems, and (ii) 12 months as to the remaining systems and other elements of the Building. If Lessee does not give Lessor the required notice within the appropriate warranty period, correction of any such non-compliance, malfunction or failure shall be the obligation of Lessee at Lessee's sole cost and expense. Lessor also warrants, that unless otherwise specified in writing, Lessor is unaware of (i) any recorded Notices of Default affecting the Premise; (ii) any delinquent amounts due under any loan secured by the Premises; and (iii) any bankruptcy proceeding affecting the Premises.

2.3 **Compliance**. Lessor warrants that the Premises comply with the building codes, applicable laws, covenants or restrictions of record, regulations, and ordinances including without limitation the Americans with Disabilities Act ("**Applicable Requirements**") that were in effect at the time that each improvement, or portion thereof, was constructed. Said warranty does not apply to the use to which Lessee will put the Premises, modifications which may be required by the Americans with Disabilities Act or any similar laws as a result of Lessee's specific and unique use (see Paragraph 49), or to any Alterations or Utility Installations (as defined in Paragraph 7.3(a)) made or to be made by Lessee. For purposes of this Lease all references to Lessee's "specific and unique" use shall mean Lessee's operation as a business that manufactures and sells portable medical equipment (as compared with general office, research and development and other industrial uses). **NOTE: Lessee is responsible for determining whether or not the Applicable Requirements, and especially the zoning, are appropriate for Lessee's intended use, and acknowledges that past uses of the Premises may no longer be allowed.** If the Premises do not comply with said warranty, Lessor shall, except as otherwise provided, promptly after receipt of written notice from Lessee or the appropriate governmental agency setting forth with specificity the nature and extent of such non-compliance, rectify the same at Lessor's expense. If Lessee or the appropriate governmental agency does not give Lessor written notice of a non-compliance with this warranty within 12 months following the Start Date, correction of that non-compliance shall be the obligation of Lessee at Lessee's sole cost and expense. If the Applicable Requirements are hereafter changed so as to require during the term of this Lease the construction of an addition to or an alteration of the Premises and/or Building, the remediation of any Hazardous Substance, or the reinforcement or other physical modification of the Unit, Premises and/or Building ("**Capital Expenditure**"), Lessor and Lessee shall allocate the cost of such work as follows:

(a) Subject to Paragraph 2.3(c) below, if such Capital Expenditures are required as a result of the specific and unique use of the Premises by Lessee as compared with uses by tenants in general, Lessee shall be fully responsible for the cost thereof, provided, however, that if such Capital Expenditure is required during the last 2 years of this Lease and the cost thereof exceeds 6 months' Base Rent, Lessee may instead terminate this Lease unless Lessor notifies Lessee, in writing, within 10 days after receipt of Lessee's termination notice that Lessor has elected to pay the difference between the actual cost thereof and an amount equal to 6 months' Base Rent. If Lessee elects termination, Lessee shall, as soon as reasonably practical, cease the use of the Premises which requires such Capital Expenditure and deliver to Lessor written notice specifying a termination date at least 90 days thereafter. Such termination date shall, however, in no event be earlier than the last day that Lessee could legally utilize the Premises without commencing such Capital Expenditure.

(b) If such Capital Expenditure is not the result of the specific and unique use of the Premises by Lessee (such as, governmentally mandated seismic modifications), then Lessor shall pay for such Capital Expenditure and Lessee shall only be obligated to pay, each month during the remainder of the term of this Lease or any extension thereof, on the date that on which the Base Rent is due, an amount equal to 1/144th of the portion of such costs reasonably attributable to the Premises. Lessee shall pay Interest on the balance but may prepay its obligation at any time. If, however, such Capital Expenditure is required during the last 2 years of this Lease and the cost of such Capital Expenditure exceeds 6 months' Base Rent then payable by Lessee, Lessor shall have the option to terminate this Lease upon 6 months-prior written notice to Lessee unless Lessee notifies Lessor, in writing, within 10 days after receipt of Lessor's termination notice that either (i) Lessee will pay for such Capital Expenditure, or (ii) Lessee elects to exercise an option to extend the term of this Lease pursuant to Paragraph 52. If Lessor does not elect to terminate, and fails to tender its share of any such Capital Expenditure, Lessee may advance such funds and deduct same, with Interest, from Rent until Lessor's share of such costs have been fully paid. If Lessee is unable to finance Lessor's share, or if the balance of the Rent due and payable for the remainder of this Lease is not sufficient to fully reimburse Lessee on an offset basis, Lessee shall have the right to terminate this Lease upon 30 days written notice to Lessor.

(c) Notwithstanding the above, the provisions concerning Capital Expenditures are intended to apply only to non-voluntary, unexpected, and new Applicable Requirements. If the Capital Expenditures are instead triggered by Lessee as a result or actual or proposed change in use, change in intensity of use, or modification to the Premises then, and in that event, Lessee shall either: (i) cease such changed use or intensity of use as soon as reasonably practical, but in no event later than the last day that Lessee could legally utilize the Premises without commencing the Capital Expenditures, and/or take such other steps as may be necessary to eliminate the requirement for such Capital Expenditure, or (ii) complete such Capital Expenditure at its own expense. Lessee shall not, however, have any right to terminate this Lease.

2.4 **Acknowledgements**. Lessee acknowledges that: neither Lessor, Lessor's agents, nor Brokers have made any oral or written representations or warranties with respect to any matters other than as set forth in this Lease. In addition, Lessor acknowledges that: (i) Brokers have made no representations, promises or warranties concerning Lessee's ability to honor the Lease or suitability to occupy the Premises, and (ii) it is Lessor's sole responsibility to investigate the financial capability and/or suitability of all proposed tenants.

3. Term.

3.1 **Term**. The Commencement Date, Expiration Date and Original Term of this Lease are as specified in Paragraph 1.3.

3.2 **Early Possession**. Any provision herein granting Lessee Early Possession of the Premises is subject to and conditioned upon the Premises being available for such possession prior to the Commencement Date. Any grant of Early Possession only conveys a non-exclusive right to occupy the Premises. If Lessee totally or partially occupies the Premises prior to the Commencement Date, the obligation to pay Base Rent, Operating Expenses, Real Property Taxes and insurance premiums shall be abated for the period of such Early Possession. All other terms of this Lease (including but not limited to the obligations to maintain the Premises) shall be in effect during such period. Any such Early Possession shall not affect the Expiration Date.

3.3 **Delay In Possession**. Lessor agrees to use its best commercially reasonable efforts to deliver possession of the Premises to Lessee by the Commencement Date. If, despite said efforts, Lessor is unable to deliver possession by such date, Lessor shall not be subject to any liability therefor, except as set forth in Paragraph 55, nor shall such failure affect the validity of this Lease or change the Expiration Date. Lessee shall not, however, be obligated to pay Rent or perform its other obligations until Lessor delivers possession of the Premises and any period of rent abatement that Lessee would otherwise have enjoyed shall run from the date of delivery of possession and continue for a period equal to what Lessee would otherwise have enjoyed under the terms hereof, but minus any days of delay caused by the acts or omissions of Lessee (See also Paragraph 55.)

3.4 **Lessee Compliance**. Lessor shall not be required to tender possession of the Premises to Lessee until Lessee complies with its obligation to provide evidence of insurance (Paragraph 8.5). Pending delivery of such evidence, Lessee shall be required to perform all of its obligations under this Lease from and after the Start Date, including the payment of Rent, notwithstanding Lessor's election to withhold possession pending receipt of such evidence of insurance. Further, if Lessee is required to perform any other conditions prior to or concurrent with the Start Date, the Start Date shall occur but Lessor may elect to withhold possession until such conditions are satisfied.

4. Rent.

4.1 **Rent Defined**. All monetary obligations of Lessee to Lessor under the terms of this Lease (except for the Security Deposit) are deemed to be rent ("**Rent**"). All rent shall be payable to RAF Pacifica Group - Real Estate Fund IV, LLC.

4.2 **Payment**. Lessee shall cause payment of Rent to be received by Lessor in lawful money of the United States, without offset or deduction (except as specifically permitted in this Lease), on or before the day on which it is due. In the event that any invoice prepared by Lessor is inaccurate such inaccuracy shall not constitute a waiver and Lessee shall be obligated to pay the amount set forth in this Lease. Rent for any period during the term hereof which is for less than one full calendar month shall be prorated based upon the actual number of days of said month. Payment of Rent shall be made to Lessor at its address stated herein or to such other persons or place as Lessor may from time to time designate in writing. Lessee may pay Rent by way of ACH transfer or wire transfer to an account designated by Lessor. Acceptance of a payment which is less than the amount then due shall not be a waiver of Lessor's rights to the balance of such Rent, regardless of Lessor's endorsement of any check so stating. In the event that any check, draft, or other instrument of payment given by Lessee to Lessor is dishonored for any reason, Lessee agrees to pay to Lessor the sum of $25 in addition to any Late Charge. Payments will be applied first to accrued late charges and attorney's fees, second to accrued interest, then to Base Rent, Insurance and Real Property Taxes, and any remaining amount to any other outstanding charges or costs.

4.3 **Association Fees**. In addition to the Base Rent, Lessee shall pay to Lessor each month an amount equal to any owner's association or condominium fees levied or assessed against the Premises. Said monies shall be paid at the same time and in the same manner as the Base Rent.

5. Security Deposit. Lessee shall deposit with Lessor upon execution hereof the Security Deposit as security for Lessee's faithful performance of its obligations under this Lease. If Lessee fails to pay Rent, or otherwise Defaults under this Lease, Lessor may use, apply or retain all or any portion of said Security Deposit for the payment of any amount already due Lessor, for Rents which will be due in the future, and/ or to reimburse or compensate Lessor for any liability, expense, loss or damage which Lessor may suffer or incur by reason thereof. If Lessor uses or applies all or any portion of the Security Deposit, Lessee shall within 10 days after written request therefor deposit monies with Lessor sufficient to restore said Security Deposit to the full amount required by this Lease. Should the Agreed Use be amended to accommodate a material change in the business of Lessee or to accommodate a sublessee or assignee, Lessor shall have the right to increase the Security Deposit to the extent necessary, in Lessor's reasonable judgment, to account for any increased wear and tear that the Premises may suffer as a result thereof. If a change in control of Lessee occurs during this Lease and following such change the financial condition of Lessee is, in Lessor's reasonable judgment, significantly reduced (as compared against Lessee's financial condition within 6 months prior to the change in control), Lessee shall deposit such additional monies with Lessor as shall be sufficient to cause the Security Deposit to be at a commercially reasonable level based on such change in financial condition. Lessor shall not be required to keep the Security Deposit separate from its general accounts. Within 90 days after the expiration or termination of this Lease, Lessor shall return that portion of the Security Deposit not used or applied by Lessor. Lessor shall upon written request provide Lessee with an accounting showing how that portion of the Security Deposit that was not returned was applied. No part of the Security Deposit shall be considered to be held in trust, to bear interest or to be prepayment for any monies to be paid by Lessee under this Lease. THE SECURITY DEPOSIT SHALL NOT BE USED BY LESSEE IN LIEU OF PAYMENT OF THE LAST MONTH'S RENT. (See also Paragraph 68.)

6. Use.

6.1 **Use**. Lessee shall use and occupy the Premises only for the Agreed Use, or any other legal use which is reasonably comparable thereto, and for no other purpose. Lessee shall not use or permit the use of the Premises in a manner that is unlawful, creates damage, waste or a nuisance, or that disturbs occupants of or causes damage to neighboring premises or properties. Other than guide, signal and seeing eye dogs, Lessee shall not keep or allow in the Premises any pets, animals, birds, fish, or reptiles. Lessor shall not unreasonably withhold or delay its consent to any written request for a modification of the Agreed Use, so long as the same will not impair the structural integrity of the improvements on the premises or the mechanical or electrical systems therein, and/or is not significantly more burdensome to the Premises. If Lessor elects to withhold consent, Lessor shall within 7 days after such request give written notification of same, which notice shall include an explanation of Lessor's objections to the change in the Agreed Use.

6.2 **Hazardous Substances**.

(a) **Reportable Uses Require Consent**. The term "**Hazardous Substance**" as used in this Lease shall mean any product, substance, or waste whose presence, use, manufacture, disposal, transportation, or release, either by itself or in combination with other materials expected to be on the Premises, is either: (i) potentially injurious to the public health, safety or welfare, the environment or the Premises, (ii) regulated or monitored by any governmental authority, or (iii) a basis for potential liability of Lessor to any governmental agency or third party under any applicable statute or common law theory. Hazardous Substances shall include, but not be limited to, hydrocarbons, petroleum, gasoline, and/or crude oil or any products, by-products or fractions thereof. Lessee shall not engage in any activity in or on the Premises which constitutes a Reportable Use of Hazardous Substances without the express prior written consent of Lessor and timely compliance (at Lessee's expense) with all Applicable Requirements. "**Reportable Use**" shall mean (i) the installation or use of any above or below ground storage tank, (ii) the generation, possession, storage, use, transportation, or disposal of a Hazardous Substance that requires a permit from, or with respect to which a report, notice, registration or business plan is required to be filed with, any governmental authority, and/or (iii) the presence at the Premises of a Hazardous Substance with respect to which any Applicable Requirements requires that a notice be given to persons entering or occupying the Premises or neighboring properties. Notwithstanding the foregoing, Lessee may use any ordinary and customary materials reasonably required to be used in the normal course of the Agreed Use, ordinary office supplies (copier toner, liquid paper, glue, etc.) and common household cleaning materials, so long as such use is in compliance with all Applicable Requirements, is not a Reportable Use, and does not expose the Premises or neighboring property to any meaningful risk of contamination or damage or expose Lessor to any liability therefor. In addition, Lessor may condition its consent to any Reportable Use upon receiving such additional assurances as Lessor reasonably deems necessary to protect itself, the public, the Premises and/or the environment against damage, contamination, injury and/or liability, including, but not limited to, the installation (and removal on or before Lease expiration or termination) of protective modifications (such as concrete encasements) and/or increasing the Security Deposit.

(b) **Duty to Inform Lessor**. If Lessee knows, or has reasonable cause to believe, that a Hazardous Substance has come to be located in, on, under or about the Premises, other than as previously consented to by Lessor, Lessee shall promptly give written notice of such fact to Lessor, and provide Lessor with a copy of any report, notice, claim or other documentation which it has concerning the presence of such Hazardous Substance.

(c) **Lessee Remediation**. Lessee shall not cause or permit any Hazardous Substance to be spilled or released in, on, under, or about the Premises (including through the plumbing or sanitary sewer system) and shall promptly, at Lessee's expense, comply with all Applicable Requirements and take all investigatory and/or remedial action reasonably recommended, whether or not formally ordered or required, for the cleanup of any contamination of, and for the maintenance, security and/or monitoring of the Premises or neighboring properties, that was caused or materially contributed to by Lessee, or pertaining to or involving any Hazardous Substance brought onto the Premises during the term of this Lease, by or for Lessee, its agents, employees or invitees.

(d) **Lessee Indemnification**. Lessee shall indemnify, defend and hold Lessor, its agents, employees, lenders and ground lessor, if any, harmless from and against any and all loss of rents and/or damages, liabilities, judgments, claims, expenses, penalties, and attorneys' and consultants' fees arising out of or involving any Hazardous Substance brought onto the Premises by or for Lessee, its agents, employees or invitees (provided, however, that Lessee shall have no liability under this Lease with respect to underground

migration of any Hazardous Substance under the Premises from adjacent properties not caused or contributed to by Lessee). Lessee's obligations shall include, but not be limited to, the effects of any contamination or injury to person, property or the environment created or suffered by Lessee, and the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease. **No termination, cancellation or release agreement entered into by Lessor and Lessee shall release Lessee from its obligations under this Lease with respect to Hazardous Substances, unless specifically so agreed by Lessor in writing at the time of such agreement.**

(e) **Lessor Indemnification**. Except as otherwise provided in paragraph 8.7, Lessor and its successors and assigns shall indemnify, defend, reimburse and hold Lessee, its employees and lenders, harmless from and against any and all environmental damages, including the cost of remediation, which result from Hazardous Substances which existed on the Premises prior to Lessee's occupancy or which are caused by the gross negligence or willful misconduct of Lessor, its agents or employees. Lessor's obligations, as and when required by the Applicable Requirements, shall include, but not be limited to, the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease.

(f) **Investigations and Remediations**. Lessor shall retain the responsibility and pay for any investigations or remediation measures required by governmental entities having jurisdiction with respect to the existence of Hazardous Substances on the Premises prior to Lessee's occupancy, unless such remediation measure is required as a result of Lessee's use (including "Alterations", as defined in paragraph 7.3(a) below) of the Premises, in which event Lessee shall be responsible for such payment. Lessee shall cooperate fully in any such activities at the request of Lessor, including allowing Lessor and Lessor's agents to have reasonable access to the Premises at reasonable times in order to carry out Lessor's investigative and remedial responsibilities.

(g) **Lessor Termination Option**. If a Hazardous Substance Condition (see Paragraph 9.1(e)) occurs during the term of this Lease, unless Lessee is legally responsible therefor (in which case Lessee shall make the investigation and remediation thereof required by the Applicable Requirements and this Lease shall continue in full force and effect, but subject to Lessor's rights under Paragraph 6.2(d) and Paragraph 13), Lessor may, at Lessor's option, either (i) investigate and remediate such Hazardous Substance Condition, if required, as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) if the estimated cost to remediate such condition exceeds 12 times the then monthly Base Rent or $100,000, whichever is greater and Lessor's insurance does not provide complete coverage of the Hazardous Substance Condition, give written notice to Lessee, within 30 days after receipt by Lessor of knowledge of the occurrence of such Hazardous Substance Condition, of Lessor's desire to terminate this Lease as of the date 60 days following the date of such notice. In the event Lessor elects to give a termination notice, Lessee may, within 10 days thereafter, give written notice to Lessor of Lessee's commitment to pay the amount by which the cost of the remediation of such Hazardous Substance Condition exceeds an amount equal to 12 times the then monthly Base Rent or $100,000, whichever is greater. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days following such commitment. In such event, this Lease shall continue in full force and effect, and Lessor shall proceed to make such remediation as soon as reasonably possible after the required funds are available. If Lessee does not give such notice and provide the required funds or assurance thereof within the time provided, this Lease shall terminate as of the date specified in Lessor's notice of termination.

6.3 **Lessee's Compliance with Applicable Requirements**. Except as otherwise provided in this Lease, Lessee shall, at Lessee's sole expense, fully, diligently and in a timely manner, materially comply with all Applicable Requirements, the requirements of any applicable fire insurance underwriter or rating bureau, and the recommendations of Lessor's engineers and/or consultants which relate in any manner to the Premises, without regard to whether said Applicable Requirements are now in effect or become effective after the Start Date. Lessee shall, within 10 days after receipt of Lessor's written request, provide Lessor with copies of all permits and other documents, and other information evidencing Lessee's compliance with any Applicable Requirements specified by Lessor, and shall immediately upon receipt, notify Lessor in writing (with copies of any documents involved) of any threatened or actual claim, notice, citation, warning, complaint or report pertaining to or involving the failure of Lessee or the Premises to comply with any Applicable Requirements. Likewise, Lessee shall immediately give written notice to Lessor of: (i) any water damage to the Premises and any suspected seepage, pooling, dampness or other condition conducive to the production of mold; or (ii) any mustiness or other odors that might indicate the presence of mold in the Premises. In addition, Lessee shall provide copies of all relevant material safety data sheets (**MSDS**) to Lessor within 10 days of the receipt of a written request therefor. In addition, Lessee shall provide Lessor with copies of its business license, certificate of occupancy and/or any similar document within 10 days of the receipt of a written request therefor. A copy of the Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park that affect the Premises and the Project are attached as Exhibit C hereto.

6.4 **Inspection; Compliance**. Lessor and Lessor's "**Lender**" (as defined in Paragraph 30) and consultants authorized by Lessor shall have the right to enter into Premises at any time, in the case of an emergency, and otherwise at reasonable times after reasonable notice, for the purpose of inspecting and/or testing the condition of the Premises and/or for verifying compliance by Lessee with this Lease. 24 hours shall be considered reasonable notice for purposes of this Paragraph 6.4. The cost of any such inspections shall be paid by Lessor, unless a violation of Applicable Requirements, or a Hazardous Substance Condition (see paragraph 9.1) is found to exist or be imminent, or the inspection is requested or ordered by a governmental authority. In such case, Lessee shall upon request reimburse Lessor for the cost of such inspection, so long as such inspection is reasonably related to the violation or contamination. In addition, Lessee shall provide copies of all relevant material safety data sheets (**MSDS**) to Lessor within 10 days of the receipt of a written request therefor. Lessee acknowledges that any failure on its part to allow such inspections or testing will expose Lessor to risks and potentially cause Lessor to incur costs not contemplated by this Lease, the extent of which will be extremely difficult to ascertain. Accordingly, should the Lessee fail to allow such inspections and/or testing in a timely fashion the Base Rent shall be automatically increased, without any requirement for notice to Lessee, by an amount equal to 10% of the then existing Base Rent or $100, whichever is greater until Lessee allows such inspections and/or testing. The Parties agree that such increase in Base Rent represents fair and reasonable compensation for the additional risk/costs that Lessor will incur by reason of Lessee's failure to allow such inspection and/or testing. Such increase in Base Rent shall in no event constitute a waiver of Lessee's Default or Breach with respect to such failure nor prevent the exercise of any of the other rights and remedies granted hereunder.

7. Maintenance; Repairs; Utility Installations; Trade Fixtures and Alterations.

7.1 **Lessee's Obligations**.

(a) **In General**. Subject to the provisions of Paragraph 2.2 (Condition), 2.3 (Compliance), 6.3 (Lessee's Compliance with Applicable Requirements), 7.2 (Lessor's Obligations), 9 (Damage or Destruction), and 14 (Condemnation), Lessee shall, at Lessee's sole expense, keep the Premises, Utility Installations (intended for Lessee's exclusive use, no matter where located), and Alterations in good order, condition and repair (whether or not the portion of the Premises requiring repairs, or the means of repairing the same, are reasonably or readily accessible to Lessee, and whether or not the need for such repairs occurs as a result of Lessee's use, any prior use, the elements or the age of such portion of the Premises), including, but not limited to, all equipment or facilities, such as plumbing, HVAC equipment, electrical, lighting facilities, boilers, pressure vessels, fire protection system, fixtures, walls (interior and exterior), foundations, ceilings, roofs, roof drainage systems, floors (including floor coverings), windows, doors, plate glass, skylights, landscaping, driveways, parking lots, fences, retaining walls, signs, sidewalks and parkways located in, on, or adjacent to the Premises. Lessee, in keeping the Premises in good order, condition and repair, shall exercise and perform good maintenance practices, specifically including the procurement and maintenance of the service contracts required by Paragraph 7.1(b) below. Lessee's obligations shall include restorations, replacements or renewals when necessary to keep the Premises and all improvements thereon or a part thereof in good order, condition and state of repair. Lessee shall, during the term of this Lease, keep the exterior appearance of the Building in a

first-class condition (including, e.g. graffiti removal) consistent with the exterior appearance of other similar facilities of comparable age and size in the vicinity, including, when necessary, the exterior repainting of the Building.

(b) **Service Contracts**. Lessee shall, at Lessee's sole expense, procure and maintain contracts, with copies to Lessor, in customary form and substance for, and with contractors specializing and experienced in the maintenance of the following equipment and improvements, if any, if and when installed on the Premises: (i) HVAC equipment, (ii) boiler, and pressure vessels, (iii) fire extinguishing systems, including fire alarm and/or smoke detection, (iv) landscaping and irrigation systems, (v) roof covering and drains, and (vi) clarifiers. However, Lessor reserves the right, upon notice to Lessee, to procure and maintain any or all of such service contracts, and Lessee shall reimburse Lessor, upon demand, for the cost thereof.

(c) **Failure to Perform**. If Lessee fails to perform Lessee's obligations under this Paragraph 7.1, Lessor may enter upon the Premises after 10 days' prior written notice to Lessee (except in the case of an emergency, in which case no notice shall be required), perform such obligations on Lessee's behalf, and put the Premises in good order, condition and repair, and Lessee shall promptly pay to Lessor a sum equal to 115% of the cost thereof.

(d) **Replacement**. Subject to Lessee's indemnification of Lessor as set forth in Paragraph 8.7 below, and without relieving Lessee of liability resulting from Lessee's failure to exercise and perform good maintenance practices, if an item described in Paragraph 7.1(b) cannot be repaired other than at a cost which is in excess of 50% of the cost of replacing such item, then such item shall be replaced by Lessor, and the cost thereof shall be prorated between the Parties and Lessee shall only be obligated to pay, each month during the remainder of the term of this Lease, on the date on which Base Rent is due, an amount equal to the product of multiplying the cost of such replacement by a fraction, the numerator of which is one, and the denominator of which is 144 (i.e. 1/144th of the cost per month). Lessee shall pay Interest on the unamortized balance but may prepay its obligation at any time.

7.2 **Lessor's Obligations**. Subject to the provisions of Paragraphs 2.2 (Condition), 2.3 (Compliance), 9 (Damage or Destruction) and 14 (Condemnation), it is intended by the Parties hereto that Lessor have no obligation, in any manner whatsoever, to repair and maintain the Premises, or the equipment therein, all of which obligations are intended to be that of the Lessee. It is the intention of the Parties that the terms of this Lease govern the respective obligations of the Parties as to maintenance and repair of the Premises. (See also Paragraph 59.)

7.3 **Utility Installations; Trade Fixtures; Alterations**.

(a) **Definitions**. The term "**Utility Installations**" refers to all floor and window coverings, air and/or vacuum lines, power panels, electrical distribution, security and fire protection systems, communication cabling, lighting fixtures, HVAC equipment, plumbing, and fencing in or on the Premises. The term "**Trade Fixtures**" shall mean Lessee's machinery and equipment that can be removed without doing material damage to the Premises. The term "Alterations" shall mean any modification of the improvements, other than Utility Installations or Trade Fixtures, whether by addition or deletion. "**Lessee Owned Alterations and/or Utility Installations**" are defined as Alterations and/or Utility Installations made by Lessee that are not yet owned by Lessor pursuant to Paragraph 7.4(a).

(b) **Consent**. Lessee shall not make any Alterations or Utility Installations to the Premises without Lessor's prior written consent. Lessee may, however, make non-structural Alterations or Utility Installations to the interior of the Premises (excluding the roof) without such consent but upon notice to Lessor, as long as they are not visible from the outside, do not involve puncturing, relocating or removing the roof or any existing walls, will not affect the electrical, plumbing, HVAC, and/or life safety systems, do not trigger the requirement for additional modifications and/or improvements to the Premises resulting from Applicable Requirements, such as compliance with Title 24, and the cumulative cost thereof during this Lease as extended does not exceed a sum equal to 3 month's Base Rent in the aggregate or a sum equal to one month's Base Rent in any one year. Notwithstanding the foregoing, Lessee shall not make or permit any roof penetrations and/or install anything on the roof without the prior written approval of Lessor. Lessor may, as a precondition to granting such approval, require Lessee to utilize a contractor chosen and/or approved by Lessor. Any Alterations or Utility Installations that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written form with detailed plans. Consent shall be deemed conditioned upon Lessee's: (i) acquiring all applicable governmental permits, (ii) furnishing Lessor with copies of both the permits and the plans and specifications prior to commencement of the work, and (iii) compliance with all conditions of said permits and other Applicable Requirements in a prompt and expeditious manner. Any Alterations or Utility Installations shall be performed in a workmanlike manner with good and sufficient materials. Lessee shall promptly upon completion furnish Lessor with as-built plans and specifications. For work which costs an amount in excess of three month's Base Rent, Lessor may condition its consent upon Lessee providing a lien and completion bond in an amount equal to 150% of the estimated cost of such Alteration or Utility Installation and/or upon Lessee's posting an additional Security Deposit with Lessor.

(c) **Liens; Bonds**. Lessee shall pay, when due, all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use on the Premises, which claims are or may be secured by any mechanic's or materialmen's lien against the Premises or any interest therein. Lessee shall give Lessor not less than 10 days notice prior to the commencement of any work in, on or about the Premises, and Lessor shall have the right to post notices of non-responsibility. If Lessee shall contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense defend and protect itself, Lessor and the Premises against the same and shall pay and satisfy any such adverse judgment that may be rendered thereon before the enforcement thereof. If Lessor shall require, Lessee shall furnish a surety bond in an amount equal to 150% of the amount of such contested lien, claim or demand, indemnifying Lessor against liability for the same. If Lessor elects to participate in any such action, Lessee shall pay Lessor's attorneys' fees and costs.

7.4 **Ownership; Removal; Surrender; and Restoration**.

(a) **Ownership**. Subject to Lessor's right to require removal or elect ownership as hereinafter provided, all Alterations and Utility Installations made by Lessee shall be the property of Lessee, but considered a part of the Premises. Lessor may, at any time, elect in writing to be the owner of all or any specified part of the Lessee Owned Alterations and Utility Installations. Unless otherwise instructed per paragraph 7.4(b) hereof, all Lessee Owned Alterations and Utility Installations shall, at the expiration or termination of this Lease, become the property of Lessor and be surrendered by Lessee with the Premises.

(b) **Removal**. Except to the extent that Lessor notifies Lessee at the time of its consent to any Alterations or Utility Installations as provided in Paragraph 7.3(b) or this Paragraph 7.4(b) below, by delivery to Lessee of written notice from Lessor not earlier than 90 and not later than 30 days prior to the end of the term of this Lease, Lessor may require that any or all Lessee Owned Alterations or Utility Installations be removed by the expiration or termination of this Lease. Lessor may require the removal at any time of all or any part of any Lessee Owned Alterations or Utility Installations made without the required consent. Notwithstanding the foregoing, Lessee shall have no obligation to remove the Lessee Improvements installed pursuant to the Work Letter attached to this Lease.

(c) **Surrender; Restoration**. Lessee shall surrender the Premises by the Expiration Date or any earlier termination date, with all of the improvements, parts and surfaces thereof broom clean and free of debris, and in good operating order, condition and state of repair, ordinary wear and tear excepted. "Ordinary wear and tear" shall not include any damage or deterioration that would have been prevented by good maintenance practice. Notwithstanding the foregoing and the provisions of Paragraph 7.1(a), if the Lessee occupies the Premises for 12 months or less, then Lessee shall surrender the Premises in the same condition as delivered to Lessee on the Start Date with NO allowance for ordinary wear and tear. Lessee shall repair any damage occasioned by the installation, maintenance or removal of Trade Fixtures, Lessee owned Alterations and/or Utility Installations, furnishings, and equipment as well as the removal of any storage tank installed by or for Lessee. Lessee shall also remove from the Premises any and all Hazardous Substances brought onto the Premises by or for Lessee, its agents, employees or invitees (except Hazardous Substances which were deposited via underground

migration from areas outside of the Premises) to the level specified in Applicable Requirements. Trade Fixtures shall remain the property of Lessee and shall be removed by Lessee. Any personal property of Lessee not removed on or before the Expiration Date or any earlier termination date shall be deemed to have been abandoned by Lessee and may be disposed of or retained by Lessor as Lessor may desire. The failure by Lessee to timely vacate the Premises pursuant to this Paragraph 7.4(c) without the express written consent of Lessor shall constitute a holdover under the provisions of Paragraph 26 below.

8. Insurance; Indemnity.

8.1 **Payment For Insurance**. Lessee shall pay for all insurance required under Paragraph 8 except to the extent of the cost attributable to liability insurance carried by Lessor under Paragraph 8.2(b) in excess of $2,000,000 per occurrence. Premiums for policy periods commencing prior to or extending beyond the Lease term shall be prorated to correspond to the Lease term. Payment shall be made by Lessee to Lessor within 10 days following receipt of an invoice. (See also Paragraph 60.)

8.2 **Liability Insurance**.

(a) **Carried by Lessee**. Lessee shall obtain and keep in force a Commercial General Liability policy of insurance protecting Lessee and Lessor and Lessor's property manager as an additional insured against claims for bodily injury, personal injury, owned/non-owned/hired auto liability and property damage based upon or arising out of the ownership, use, occupancy or maintenance of the Premises and all areas appurtenant thereto. Such insurance shall be on an occurrence basis providing single limit coverage in an amount not less than $1,000,000 per occurrence with an annual aggregate of not less than $2,000,000. Lessee shall add Lessor and Lessor's property manager as an additional insured by means of an endorsement at least as broad as the Insurance Service Organization's "Additional Insured-Managers and Lessors of Premises" Endorsement. The policy shall not contain any intra-insured exclusions as between insured persons or organizations, but shall include coverage for liability assumed under this Lease as an "**insured contract**" for the performance of Lessee's indemnity obligations under this Lease. The limits of said insurance shall not, however, limit the liability of Lessee nor relieve Lessee of any obligation hereunder. Lessee shall provide an endorsement on its liability policy(ies) which provides that its insurance shall be primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only.

(b) **Carried by Lessor**. Lessor shall maintain liability insurance as described in Paragraph 8.2(a), in addition to, and not in lieu of, the insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein.

8.3 **Property Insurance - Building, Improvements and Rental Value**.

(a) **Building and Improvements**. The Insuring Party shall obtain and keep in force a policy or policies in the name of Lessor,with loss payable to Lessor, any ground-lessor, and to any Lender insuring loss or damage to the Premises. The amount of such insurance shall be equal to the full insurable replacement cost of the Premises, as the same shall exist from time to time, or the amount required by any Lender, but in no event more than the commercially reasonable and available insurable value thereof. Lessee Owned Alterations and Utility Installations, Trade Fixtures, and Lessee's personal property shall be insured by Lessee not by Lessor. If the coverage is available and commercially appropriate, such policy or policies shall insure against all risks of direct physical loss or damage (except the perils of flood and/or earthquake unless required by a Lender), including coverage for debris removal and the enforcement of any Applicable Requirements requiring the upgrading, demolition, reconstruction or replacement of any portion of the Premises as the result of a covered loss. Said policy or policies shall also contain an agreed valuation provision in lieu of any coinsurance clause, waiver of subrogation, and inflation guard protection causing an increase in the annual property insurance coverage amount by a factor of not less than the adjusted U.S. Department of Labor Consumer Price Index for All Urban Consumers for the city nearest to where the Premises are located. If such insurance coverage has a deductible clause, the deductible amount shall not exceed $5,000 per occurrence, and Lessee shall be liable for such deductible amount in the event of an Insured Loss.

(b) **Rental Value**. The Insuring Party shall obtain and keep in force a policy or policies in the name of Lessor with loss payable to Lessor and any Lender, insuring the loss of the full Rent for one year with an extended period of indemnity for an additional 180 days ("Rental Value insurance"). Said insurance shall contain an agreed valuation provision in lieu of any coinsurance clause, and the amount of coverage shall be adjusted annually to reflect the projected Rent otherwise payable by Lessee, for the next 12 month period. Lessee shall be liable for any deductible amount in the event of such loss.

(c) **Adjacent Premises**. If the Premises are part of a larger building, or of a group of buildings owned by Lessor which are adjacent to the Premises, the Lessee shall pay for any increase in the premiums for the property insurance of such building or buildings if said increase is caused by Lessee's acts, omissions, use or occupancy of the Premises.

8.4 **Lessee's Property; Business Interruption Insurance; Worker's Compensation Insurance**.

(a) **Property Damage**. Lessee shall obtain and maintain insurance coverage on all of Lessee's personal property, Trade Fixtures, and Lessee Owned Alterations and Utility Installations. Such insurance shall be full replacement cost coverage with a deductible of not to exceed $1,000 per occurrence. The proceeds from any such insurance shall be used by Lessee for the replacement of personal property, Trade Fixtures and Lessee Owned Alterations and Utility Installations.

(b) **Business Interruption**. Lessee shall obtain and maintain loss of income and extra expense insurance in amounts as will reimburse Lessee for direct or indirect loss of earnings attributable to all perils commonly insured against by prudent lessees in the business of Lessee or attributable to prevention of access to the Premises as a result of such perils.

(c) **Worker's Compensation Insurance**. Lessee shall obtain and maintain Worker's Compensation Insurance in such amount as may be required by Applicable Requirements. Such policy shall include a 'Waiver of Subrogation' endorsement. Lessee shall provide Lessor with a copy of such endorsement along with the certificate of insurance or copy of the policy required by paragraph 8.5.

(d) **No Representation of Adequate Coverage**. Lessor makes no representation that the limits or forms of coverage of insurance specified herein are adequate to cover Lessee's property, business operations or obligations under this Lease.

8.5 **Insurance Policies**. Insurance required herein shall be by companies maintaining during the policy term a "General Policyholders Rating" of at least A-, VII, as set forth in the most current issue of "Best's Insurance Guide", or such other rating as may be required by a Lender. Lessee shall not do or permit to be done anything which invalidates the required insurance policies. Lessee shall, prior to the Start Date, deliver to Lessor certified copies of policies of such insurance or certificates with copies of the required endorsements evidencing the existence and amounts of the required insurance. No such policy shall be cancelable or subject to modification except after 30 days prior written notice to Lessor. Lessee shall, at least 10 days prior to the expiration of such policies, furnish Lessor with evidence of renewals or "insurance binders" evidencing renewal thereof, or Lessor, following notice to Lessee and Lessee's failure to deliver such evidence to Lessor within ten (10) days thereafter, may increase his liability insurance coverage and charge the cost thereof to Lessee, which amount shall be payable by Lessee to Lessor upon demand. Such policies shall be for a term of at least one year, or the length of the remaining term of this Lease, whichever is less. If either Party shall fail to procure and maintain the insurance required to be carried by it, the other Party may, but shall not be required to, procure and maintain the same.

8.6 **Waiver of Subrogation**. Without affecting any other rights or remedies, Lessee and Lessor each hereby release and relieve the other, and waive their entire right to recover damages against the other, for loss of or damage to its property arising out of or incident to the perils required to be insured against herein. The effect of such releases and waivers is not limited by the amount of insurance carried or required, or by any deductibles applicable hereto. The Parties agree to have their respective property damage insurance carriers waive any right to subrogation that such companies may have against Lessor or Lessee, as the case may be, so long as the insurance is not invalidated thereby.

8.7 **Indemnity**. Except for Lessor's negligence or willful misconduct, Lessee shall indemnify, protect, defend and hold harmless the Premises, Lessor and its agents, Lessor's master or ground lessor, partners and Lenders, from and against any and all claims, loss of rents and/or damages, liens, judgments, penalties, attorneys' and consultants' fees, expenses and/or liabilities arising out of, involving, or

in connection with, a Breach of the Lease by Lessee and/or the use and/or occupancy of the Premises and/or Project by Lessee and/or by Lessee's employees, contractors or invitees. If any action or proceeding is brought against Lessor by reason of any of the foregoing matters, Lessee shall upon notice defend the same at Lessee's expense by counsel reasonably satisfactory to Lessor and Lessor shall cooperate with Lessee in such defense. Lessor need not have first paid any such claim in order to be defended or indemnified.

8.8 **Exemption of Lessor and its Agents from Liability**. Notwithstanding the negligence or breach of this Lease by Lessor or its agents, but without limiting Lessor's liability for any of its covenants, obligations or warranties expressly set forth in this Lease (nor any of Lessee's releases and waivers set forth in Paragraph 8.6) neither Lessor nor its agents shall be liable under any circumstances for: (i) injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessee's employees, contractors, invitees, customers, or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, indoor air quality, the presence of mold or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, HVAC or lighting fixtures, or from any other cause, whether the said injury or damage results from conditions arising upon the Premises or upon other portions of the building of which the Premises are a part, or from other sources or places, (ii) any damages arising from any act or neglect of any other tenant of Lessor or from the failure of Lessor or its agents to enforce the provisions of any other lease in the Project, or (iii) injury to Lessee's business or for any loss of income or profit therefrom. Instead, it is intended that Lessee's sole recourse in the event of such damages or injury be to file a claim on the insurance policy(ies) that Lessee is required to maintain pursuant to the provisions of paragraph 8.

8.9 **Failure to Provide Insurance**. Lessee acknowledges that any failure on its part to obtain or maintain the insurance required herein will expose Lessor to risks and potentially cause Lessor to incur costs not contemplated by this Lease, the extent of which will be extremely difficult to ascertain. Accordingly, for any month or portion thereof that Lessee does not maintain the required insurance and/or does not provide Lessor with the required binders or certificates evidencing the existence of the required insurance, which failure is not cured within 10 days following written notice thereof from Lessor, the Base Rent shall be automatically increased, without any requirement for notice to Lessee, by an amount equal to 10% of the then existing Base Rent or $100, whichever is greater. The parties agree that such increase in Base Rent represents fair and reasonable compensation for the additional risk/costs that Lessor will incur by reason of Lessee's failure to maintain the required insurance. Such increase in Base Rent shall in no event constitute a waiver of Lessee's Default or Breach with respect to the failure to maintain such insurance, prevent the exercise of any of the other rights and remedies granted hereunder, nor relieve Lessee of its obligation to maintain the insurance specified in this Lease.

9. Damage or Destruction.

9.1 **Definitions**.

(a) "**Premises Partial Damage**" shall mean damage or destruction to the improvements on the Premises, other than Lessee Owned Alterations and Utility Installations, which can reasonably be repaired in 6 months or less from receipt of insurance proceeds. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total.

(b) "**Premises Total Destruction**" shall mean damage or destruction to the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which cannot reasonably be repaired in 6 months or less from receipt of insurance proceeds. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total.

(c) "**Insured Loss**" shall mean damage or destruction to improvements on the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which was caused by an event required to be covered by the insurance described in Paragraph 8.3(a), and for which insurance proceeds are received (provided that the foregoing limitation shall not apply unless Lessor has maintained the required insurance coverage), less any deductible amounts or coverage limits involved.

(d) "**Replacement Cost**" shall mean the cost to repair or rebuild the improvements owned by Lessor at the time of the occurrence to their condition existing immediately prior thereto, including demolition, debris removal and upgrading required by the operation of Applicable Requirements, and without deduction for depreciation.

(e) "**Hazardous Substance Condition**" shall mean the occurrence or discovery of a condition involving the presence of, or a contamination by, a Hazardous Substance, in, on, or under the Premises which requires restoration.

9.2 **Partial Damage - Insured Loss**. If a Premises Partial Damage that is an Insured Loss occurs, then Lessor shall, at Lessor's expense (if Lessor receives insurance proceeds, provided that the foregoing limitation shall not apply unless Lessor has maintained the required insurance coverage), repair such damage (but not Lessee's Trade Fixtures or Lessee Owned Alterations and Utility Installations) as soon as reasonably possible and this Lease shall continue in full force and effect; provided, however, that Lessee shall, at Lessor's election, make the repair of any damage or destruction the total cost to repair of which is $10,000 or less, and, in such event, Lessor shall make any applicable insurance proceeds available to Lessee on a reasonable basis for that purpose. Notwithstanding the foregoing, if the required insurance was not in force or the insurance proceeds are not sufficient to effect such repair, the Insuring Party shall promptly contribute the shortage in proceeds (except as to the deductible which is Lessee's responsibility) as and when required to complete said repairs. In the event, however, such shortage was due to the fact that, by reason of the unique nature of the improvements, full replacement cost insurance coverage was not commercially reasonable and available, Lessor shall have no obligation to pay for the shortage in insurance proceeds or to fully restore the unique aspects of the Premises unless Lessee provides Lessor with the funds to cover same, or adequate assurance thereof, within 10 days following receipt of written notice of such shortage and request therefor. If Lessor receives said funds or adequate assurance thereof within said 10 day period, the party responsible for making the repairs shall complete them as soon as reasonably possible and this Lease shall remain in full force and effect. If such funds or assurance are not received, Lessor may nevertheless elect by written notice to Lessee within 10 days thereafter to: (i) make such restoration and repair as is commercially reasonable with Lessor paying any shortage in proceeds, in which case this Lease shall remain in full force and effect, or (ii) have this Lease terminate 30 days thereafter. Lessee shall not be entitled to reimbursement of any funds contributed by Lessee to repair any such damage or destruction. Premises Partial Damage due to flood or earthquake shall be subject to Paragraph 9.3, notwithstanding that there may be some insurance coverage, but the net proceeds of any such insurance shall be made available for the repairs if made by either Party.

9.3 **Partial Damage - Uninsured Loss**. If a Premises Partial Damage that is not an Insured Loss occurs, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessee's expense), Lessor may either: (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) terminate this Lease by giving written notice to Lessee within 30 days after receipt by Lessor of knowledge of the occurrence of such damage. Such termination shall be effective 60 days following the date of such notice. In the event Lessor elects to terminate this Lease, Lessee shall have the right within 10 days after receipt of the termination notice to give written notice to Lessor of Lessee's commitment to pay for the repair of such damage without reimbursement from Lessor. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days after making such commitment. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such repairs as soon as reasonably possible after the required funds are available. If Lessee does not make the required commitment, this Lease shall terminate as of the date specified in the termination notice.

9.4 **Total Destruction**. Notwithstanding any other provision hereof, if a Premises Total Destruction occurs, this Lease shall terminate 60 days following such Destruction. If the damage or destruction was caused by the gross negligence or willful misconduct of Lessee, Lessor shall have the right to recover Lessor's damages from Lessee, except as provided in Paragraph 8.6.

9.5 **Damage Near End of Term**. If at any time during the last 6 months of this Lease there is damage for which the cost to repair exceeds one month's Base Rent, whether or not an Insured Loss, either Lessor or Lessee may terminate this Lease effective 60 days following the date of occurrence of such damage by giving a written termination notice to the other party within 30 days after the date of

occurrence of such damage. Notwithstanding the foregoing, if Lessee at that time has an exercisable option to extend this Lease or to purchase the Premises, then Lessee may preserve this Lease by, (a) exercising such option and (b) providing Lessor with any shortage in insurance proceeds (or adequate assurance thereof) needed to make the repairs on or before the earlier of (i) the date which is 10 days after Lessee's receipt of Lessor's written notice purporting to terminate this Lease, or (ii) the day prior to the date upon which such option expires. If Lessee duly exercises such option during such period and provides Lessor with funds (or adequate assurance thereof) to cover any shortage in insurance proceeds, Lessor shall, at Lessor's commercially reasonable expense, repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect. If Lessee fails to exercise such option and provide such funds or assurance during such period, then this Lease shall terminate on the date specified in the termination notice and Lessee's option shall be extinguished.

9.6 **Abatement of Rent; Lessee's Remedies**.

(a) **Abatement**. In the event of Premises Partial Damage or Premises Total Destruction or a Hazardous Substance Condition for which Lessee is not responsible under this Lease, the Rent payable by Lessee for the period required for the repair, remediation or restoration of such damage shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired. All other obligations of Lessee hereunder shall be performed by Lessee, and Lessor shall have no liability for any such damage, destruction, remediation, repair or restoration except as provided herein.

(b) **Remedies**. If Lessor is obligated to repair or restore the Premises and does not commence, in a substantial and meaningful way, such repair or restoration within 90 days after such obligation shall accrue, Lessee may, at any time prior to the commencement of such repair or restoration, give written notice to Lessor and to any Lenders of which Lessee has actual notice, of Lessee's election to terminate this Lease on a date not less than 60 days following the giving of such notice. If Lessee gives such notice and such repair or restoration is not commenced within 30 days thereafter, this Lease shall terminate as of the date specified in said notice. If the repair or restoration is commenced within such 30 days, this Lease shall continue in full force and effect. "Commence" shall mean either the unconditional authorization of the preparation of the required plans, or the beginning of the actual work on the Premises, whichever first occurs.

9.7 **Termination; Advance Payments**. Upon termination of this Lease pursuant to Paragraph 6.2(g) or Paragraph 9, an equitable adjustment shall be made concerning advance Base Rent and any other advance payments made by Lessee to Lessor. Lessor shall, in addition, return to Lessee so much of Lessee's Security Deposit as has not been, or is not then required to be, used by Lessor

9.8 **Waive Statutes.** Lessor and Lessee agree that the terms of the Lease shall govern the effect of any damage to or destruction of the Premises with respect to termination of this Lease and hereby waive the provisions of any present or future statute to the extent inconsistent herewith, including, but not limited to, Section 1932(2) and 1933(4) of the California Civil Code (as may be amended or supplements from time to time).

10. Real Property Taxes.

10.1 **Definition**. As used herein, the term "**Real Property Taxes**" shall include any form of assessment; real estate, general, special, ordinary or extraordinary, or rental levy or tax (other than inheritance, personal income or estate taxes); improvement bond; and/or license fee imposed upon or levied against any legal or equitable interest of Lessor in the Premises or the Project, Lessor's right to other income therefrom, and/or Lessor's business of leasing, by any authority having the direct or indirect power to tax and where the funds are generated with reference to the Building address. Real Property Taxes shall also include any tax, fee, levy, assessment or charge, or any increase therein: (i) imposed by reason of events occurring during the term of this Lease, including but not limited to, a change in the ownership of the Premises, and (ii) levied or assessed on machinery or equipment provided by Lessor to Lessee pursuant to this Lease.

10.2 **Payment of Taxes**. In addition to Base Rent, Lessee shall pay to Lessor an amount equal to the Real Property Tax installment due at least 20 days prior to the applicable delinquency date. If any such installment shall cover any period of time prior to or after the expiration or termination of this Lease, Lessee's share of such installment shall be prorated. In the event Lessee incurs a late charge on any Rent payment, Lessor may estimate the current Real Property Taxes, and require that such taxes be paid in advance to Lessor by Lessee monthly in advance with the payment of the Base Rent. Such monthly payments shall be an amount equal to the amount of the estimated installment of taxes divided by the number of months remaining before the month in which said installment becomes delinquent. When the actual amount of the applicable tax bill is known, the amount of such equal monthly advance payments shall be adjusted as required to provide the funds needed to pay the applicable taxes. If the amount collected by Lessor is insufficient to pay such Real Property Taxes when due, Lessee shall pay Lessor, upon demand, such additional sum as is necessary. Advance payments may be intermingled with other moneys of Lessor and shall not bear interest. In the event of a Breach by Lessee in the performance of its obligations under this Lease, then any such advance payments may be treated by Lessor as an additional Security Deposit. (See also Paragraph 60.)

10.3 **Joint Assessment**. If the Premises are not separately assessed, Lessee's liability shall be an equitable proportion of the Real Property Taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be conclusively determined by Lessor from the respective valuations assigned in the assessor's work sheets or such other information as may be reasonably available.

10.4 **Personal Property Taxes**. Lessee shall pay, prior to delinquency, all taxes assessed against and levied upon Lessee Owned Alterations, Utility Installations, Trade Fixtures, furnishings, equipment and all personal property of Lessee. When possible, Lessee shall cause its Lessee Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor. If any of Lessee's said property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee's property within 10 days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. Utilities and Services. Lessee shall pay for all water, gas, heat, light, power, telephone, trash disposal and other utilities and services supplied to the Premises, together with any taxes thereon. If any such services are not separately metered or billed to Lessee, Lessee shall pay a reasonable proportion, to be determined by Lessor, of all charges jointly metered or billed. There shall be no abatement of rent and Lessor shall not be liable in any respect whatsoever for the inadequacy, stoppage, interruption or discontinuance of any utility or service due to riot, strike, labor dispute, breakdown, accident, repair or other cause beyond Lessor's reasonable control or in cooperation with governmental request or directions.

Within fifteen days of Lessor's written request, Lessee agrees to deliver to Lessor such information, documents and/or authorization as Lessor needs in order for Lessor to comply with new or existing Applicable Requirements relating to commercial building energy usage, ratings, and/or the reporting thereof.

12. Assignment and Subletting.

12.1 **Lessor's Consent Required**. (See also Paragraph 62.)

(a) Lessee shall not voluntarily or by operation of law assign, transfer, mortgage or encumber (collectively, "**assign or assignment**") or sublet all or any part of Lessee's interest in this Lease or in the Premises without Lessor's prior written consent.

(b) Unless Lessee is a corporation and its stock is publicly traded on a national stock exchange, a change in the control of Lessee shall constitute an assignment requiring consent. The transfer, on a cumulative basis, of 50% or more of the voting control of Lessee shall constitute a change in control for this purpose.

(c) The involvement of Lessee or its assets in any transaction, or series of transactions (by way of merger, sale, acquisition,

financing, transfer, leveraged buy-out or otherwise, but excluding a sublease), whether or not a formal assignment or hypothecation of this Lease or Lessee's assets occurs, which results or will result in a reduction of the Net Worth of Lessee below the amount that is sufficient in Lessor's commercially reasonable determination to meet Lessee's obligations under this Lease, shall be considered an assignment of this Lease to which Lessor may withhold its consent. "**Net Worth of Lessee**" shall mean the net worth of Lessee (excluding any guarantors) established under generally accepted accounting principles.

(d) An assignment or subletting without Lessor's consent as required herein shall, at Lessor's option, be a Default curable after notice per Paragraph 13.1(d), or a noncurable Breach without the necessity of any notice and grace period. If Lessor elects to treat such unapproved assignment or subletting as a noncurable Breach, Lessor may either: (i) terminate this Lease, or (ii) upon 30 days written notice, increase the monthly Base Rent to 110% of the Base Rent then in effect. Further, in the event of such Breach and rental adjustment, (i) the purchase price of any option to purchase the Premises held by Lessee shall be subject to similar adjustment to 110% of the price previously in effect, and (ii) all fixed and non-fixed rental adjustments scheduled during the remainder of the Lease term shall be increased to 110% of the scheduled adjusted rent.

(e) Lessee's remedy for any breach of Paragraph 12.1 by Lessor shall be limited to compensatory damages and/or injunctive relief.

(f) Lessor may reasonably withhold consent to a proposed assignment or subletting if Lessee is in Default at the time consent is requested.

(g) Notwithstanding the foregoing, allowing a de minimis portion of the Premises, i.e. 20 square feet or less, to be used by a third party vendor in connection with the installation of a vending machine or payphone shall not constitute a subletting.

12.2 **Terms and Conditions Applicable to Assignment and Subletting**.

(a) Regardless of Lessor's consent, no assignment or subletting shall: (i) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (ii) release Lessee of any obligations hereunder, or (iii) alter the primary liability of Lessee for the payment of Rent or for the performance of any other obligations to be performed by Lessee. For clarity, a sublessee's liability shall be limited to liability for that portion of the Premises that is the subject of the sublease for the term of such sublease.

(b) Lessor may accept Rent or performance of Lessee's obligations from any person other than Lessee pending approval or disapproval of an assignment. Neither a delay in the approval or disapproval of such assignment nor the acceptance of Rent or performance shall constitute a waiver or estoppel of Lessor's right to exercise its remedies for Lessee's Default or Breach.

(c) Lessor's consent to any assignment or subletting shall not constitute a consent to any subsequent assignment or subletting.

(d) In the event of any Default or Breach by Lessee, Lessor may proceed directly against Lessee, any Guarantors or anyone else responsible for the performance of Lessee's obligations under this Lease, including any assignee or sublessee, without first exhausting Lessor's remedies against any other person or entity responsible therefor to Lessor, or any security held by Lessor.

(e) Each request for consent to an assignment or subletting shall be in writing, accompanied by information relevant to Lessor's determination as to the financial and operational responsibility and appropriateness of the proposed assignee or sublessee, including but not limited to the intended use and/or required modification of the Premises, if any, together with a fee of $500 as consideration for Lessor's considering and processing said request. Lessee agrees to provide Lessor with such other or additional information and/or documentation as may be reasonably requested. (See also Paragraph 36)

(f) Any assignee of, or sublessee under, this Lease shall, by reason of accepting such assignment, entering into such sublease, or entering into possession of the Premises or any portion thereof, be deemed to have assumed and agreed to conform and comply with each and every term, covenant, condition and obligation herein to be observed or performed by Lessee during the term of said assignment or sublease, other than such obligations as are contrary to or inconsistent with provisions of an assignment or sublease to which Lessor has specifically consented to in writing.

(g) Lessor's consent to any assignment or subletting shall not transfer to the assignee or sublessee any Option granted to the original Lessee by this Lease unless such transfer is specifically consented to by Lessor in writing. (See Paragraph 39.2)

12.3 **Additional Terms and Conditions Applicable to Subletting**. The following terms and conditions shall apply to any subletting by Lessee of all or any part of the Premises and shall be deemed included in all subleases under this Lease whether or not expressly incorporated therein:

(a) Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all Rent payable on any sublease, and Lessor may collect such Rent and apply same toward Lessee's obligations under this Lease; provided, however, that until a Breach shall occur in the performance of Lessee's obligations, Lessee may collect said Rent. In the event that the amount collected by Lessor exceeds Lessee's then outstanding obligations any such excess shall be refunded to Lessee. Lessor shall not, by reason of the foregoing or any assignment of such sublease, nor by reason of the collection of Rent, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice from Lessor stating that a Breach exists in the performance of Lessee's obligations under this Lease, to pay to Lessor all Rent due and to become due under the sublease. Sublessee shall rely upon any such notice from Lessor and shall pay all Rents to Lessor without any obligation or right to inquire as to whether such Breach exists, notwithstanding any claim from Lessee to the contrary.

(b) In the event of a Breach by Lessee, Lessor may, at its option, require sublessee to attorn to Lessor, in which event Lessor shall undertake the obligations of the sublessor under such sublease from the time of the exercise of said option to the expiration of such sublease; provided, however, Lessor shall not be liable for any prepaid rents or security deposit paid by such sublessee to such sublessor or for any prior Defaults or Breaches of such sublessor.

(c) Any matter requiring the consent of the sublessor under a sublease shall also require the consent of Lessor.

(d) No sublessee shall further assign or sublet all or any part of the Premises without Lessor's prior written consent.

(e) Lessor shall deliver a copy of any notice of Default or Breach by Lessee to the sublessee, who shall have the right to cure the Default of Lessee within the grace period, if any, specified in such notice. The sublessee shall have a right of reimbursement and offset from and against Lessee for any such Defaults cured by the sublessee.

13. Default; Breach; Remedies.

13.1 **Default; Breach**. A "**Default**" is defined as a failure by the Lessee to comply with or perform any of the terms, covenants, conditions or Rules and Regulations under this Lease. A "**Breach**" is defined as the occurrence of one or more of the following Defaults, and the failure of Lessee to cure such Default within any applicable grace period:

(a) The abandonment of the Premises; or the vacating of the Premises without providing a commercially reasonable level of security, or where the coverage of the property insurance described in Paragraph 8.3 is jeopardized as a result thereof, or without providing reasonable assurances to minimize potential vandalism.

(b) The failure of Lessee to make any payment of Rent or any Security Deposit required to be made by Lessee hereunder, whether to Lessor or to a third party, when due, to provide reasonable evidence of insurance or surety bond, or to fulfill any obligation under this Lease which endangers or threatens life or property, where such failure continues for a period of 3 business days following written notice to Lessee. THE ACCEPTANCE BY LESSOR OF A PARTIAL PAYMENT OF RENT OR SECURITY DEPOSIT SHALL NOT CONSTITUTE A WAIVER OF ANY OF LESSOR'S RIGHTS, INCLUDING LESSOR'S RIGHT TO RECOVER POSSESSION OF THE PREMISES.

(c) The failure of Lessee to allow Lessor and/or its agents access to the Premises or the commission of waste, act or acts constituting public or private nuisance, and/or an illegal activity on the Premises by Lessee, where such actions continue for a period of 3 business days following written notice to Lessee.

(d) The failure by Lessee to provide (i) reasonable written evidence of compliance with Applicable Requirements, (ii) the service contracts, (iii) the rescission of an unauthorized assignment or subletting, (iv) an Estoppel Certificate or financial statements, (v) a requested subordination, (vi) evidence concerning any guaranty and/or Guarantor, (vii) any document requested under Paragraph 42, (viii) material safety data sheets (MSDS), or (ix) any other documentation or information which Lessor may reasonably require of Lessee under the terms of this Lease, where any such failure continues for a period of 10 days following written notice to Lessee.

(e) A Default by Lessee as to the terms, covenants, conditions or provisions of this Lease, or of the rules adopted under Paragraph 40 hereof, other than those described in subparagraphs 13.1(a), (b), (c) or (d), above, where such Default continues for a period of 30 days after written notice; provided, however, that if the nature of Lessee's Default is such that more than 30 days are reasonably required for its cure, then it shall not be deemed to be a Breach if Lessee commences such cure within said 30 day period and thereafter diligently prosecutes such cure to completion.

(f) The occurrence of any of the following events: (i) the making of any general arrangement or assignment for the benefit of creditors; (ii) becoming a "**debtor**" as defined in 11 U.S.C. § 101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within 60 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where possession is not restored to Lessee within 30 days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged within 30 days; provided, however, in the event that any provision of this subparagraph is contrary to any applicable law, such provision shall be of no force or effect, and not affect the validity of the remaining provisions.

(g) The discovery that any financial statement of Lessee or of any Guarantor given to Lessor was materially false.

(h) If the performance of Lessee's obligations under this Lease is guaranteed: (i) the death of a Guarantor, (ii) the termination of a Guarantor's liability with respect to this Lease other than in accordance with the terms of such guaranty, (iii) a Guarantor's becoming insolvent or the subject of a bankruptcy filing, (iv) a Guarantor's refusal to honor the guaranty, or (v) a Guarantor's breach of its guaranty obligation on an anticipatory basis, and Lessee's failure, within 60 days following written notice of any such event, to provide written alternative assurance or security, which, when coupled with the then existing resources of Lessee, equals or exceeds the combined financial resources of Lessee and the Guarantors that existed at the time of execution of this Lease.

13.2 **Remedies**. If Lessee fails to perform any of its affirmative duties or obligations, within 10 days after written notice (or in case of an emergency, without notice), Lessor may, at its option, perform such duty or obligation on Lessee's behalf, including but not limited to the obtaining of reasonably required bonds, insurance policies, or governmental licenses, permits or approvals. Lessee shall pay to Lessor an amount equal to 115% of the costs and expenses incurred by Lessor in such performance upon receipt of an invoice therefor. In the event of a Breach, Lessor may, with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such Breach:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease shall terminate and Lessee shall immediately surrender possession to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the unpaid Rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) the worth at the time of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the Lessee proves could be reasonably avoided; and (iv) any other amount necessary to compensate Lessor for all the detriment proximately caused by the Lessee's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, including but not limited to the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorneys' fees, and that portion of any leasing commission paid by Lessor in connection with this Lease applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provision (iii) of the immediately preceding sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of the District within which the Premises are located at the time of award plus one percent. Efforts by Lessor to mitigate damages caused by Lessee's Breach of this Lease shall not waive Lessor's right to recover any damages to which Lessor is otherwise entitled. If termination of this Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding any unpaid Rent and damages as are recoverable therein, or Lessor may reserve the right to recover all or any part thereof in a separate suit. If a notice and grace period required under Paragraph 13.1 was not previously given, a notice to pay rent or quit, or to perform or quit given to Lessee under the unlawful detainer statute shall also constitute the notice required by Paragraph 13.1. In such case, the applicable grace period required by Paragraph 13.1 and the unlawful detainer statute shall run concurrently, and the failure of Lessee to cure the Default within the greater of the two such grace periods shall constitute both an unlawful detainer and a Breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.

(b) Continue the Lease and Lessee's right to possession and recover the Rent as it becomes due, in which event Lessee may sublet or assign, subject only to reasonable limitations. Acts of maintenance, efforts to relet, and/or the appointment of a receiver to protect the Lessor's interests, shall not constitute a termination of the Lessee's right to possession.

(c) Pursue any other remedy now or hereafter available under the laws or judicial decisions of the state wherein the Premises are located. The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

13.3 **Inducement Recapture.** Any agreement for free or abated rent or other charges, the cost of tenant improvements for Lessee paid for or performed by Lessor, or for the giving or paying by Lessor to or for Lessee of any cash or other bonus, inducement or consideration for Lessee's entering into this Lease, all of which concessions are hereinafter referred to as "**Inducement Provisions**," shall be deemed to be amortized into the Base Rent payable by Lessee over the Original Term of this Lease conditioned upon Lessee's full and faithful performance of all of the terms, covenants and conditions of this Lease. Upon Breach of this Lease by Lessee that results in a termination of the Lease, any such Inducement Provision shall automatically be deemed deleted from this Lease and of no further force or effect, and the unamortized amount of any rent, other charge, bonus, inducement or consideration theretofore abated, given or paid by Lessor under such an Inducement Provision shall be immediately due and payable by Lessee to Lessor as additional Rent. The acceptance by Lessor of rent or the cure of the Breach which initiated the operation of this paragraph shall not be deemed a waiver by Lessor of the provisions of this paragraph unless specifically so stated in writing by Lessor at the time of such acceptance.

13.4 **Late Charges**. Lessee hereby acknowledges that late payment by Lessee of Rent will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed upon Lessor by any Lender. Accordingly, if any Rent shall not be received by Lessor within 5 days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall immediately pay to Lessor a one-time late charge equal to 10% of each such overdue amount or $100, whichever is greater. The Parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of such late payment. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's Default or Breach with respect to such overdue amount, nor prevent the exercise of any of the other rights and remedies granted hereunder. In the event that a late charge is

payable hereunder, whether or not collected, for 3 consecutive installments of Base Rent, then notwithstanding any provision of this Lease to the contrary, Base Rent shall, at Lessor's option, become due and payable quarterly in advance.

13.5 **Interest**. Any monetary payment due Lessor hereunder, other than late charges, not received by Lessor, when due shall bear interest from the 31st day after it was due. The interest ("**Interest**") charged shall be computed at the rate of 10% per annum but shall not exceed the maximum rate allowed by law. Interest is payable in addition to the potential late charge provided for in Paragraph 13.4.

13.6 **Breach by Lessor**.

(a) **Notice of Breach**. Lessor shall not be deemed in breach of this Lease unless Lessor fails within a reasonable time to perform an obligation required to be performed by Lessor. For purposes of this Paragraph, a reasonable time shall in no event be less than 30 days after receipt by Lessor, and any Lender whose name and address shall have been furnished to Lessee in writing for such purpose, of written notice specifying wherein such obligation of Lessor has not been performed; provided, however, that if the nature of Lessor's obligation is such that more than 30 days are reasonably required for its performance, then Lessor shall not be in breach if performance is commenced within such 30 day period and thereafter diligently pursued to completion.

(b) **Performance by Lessee on Behalf of Lessor**. In the event that neither Lessor nor Lender cures said breach within 30 days after receipt of said notice, or if having commenced said cure they do not diligently pursue it to completion, then Lessee may elect to cure said breach at Lessee's expense and offset from Rent the actual and reasonable cost to perform such cure, provided, however, that such offset shall not exceed an amount equal to the greater of one month's Base Rent or the Security Deposit, reserving Lessee's right to seek reimbursement from Lessor for any such expense in excess of such offset. Lessee shall document the cost of said cure and supply said documentation to Lessor.

14. Condemnation. If the Premises or any portion thereof are taken under the power of eminent domain or sold under the threat of the exercise of said power (collectively "**Condemnation**"), this Lease shall terminate as to the part taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than 10% of the Building, or more than 25% of that portion of the Premises not occupied by any building, is taken by Condemnation, Lessee may, at Lessee's option, to be exercised in writing within 10 days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within 10 days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the Base Rent shall be reduced in proportion to the reduction in utility of the Premises caused by such Condemnation. Condemnation awards and/or payments shall be the property of Lessor, whether such award shall be made as compensation for diminution in value of the leasehold, the value of the part taken, or for severance damages; provided, however, that Lessee shall be entitled to any compensation paid by the condemnor for Lessee's relocation expenses, loss of business goodwill and/or Trade Fixtures, without regard to whether or not this Lease is terminated pursuant to the provisions of this Paragraph. All Alterations and Utility Installations made to the Premises by Lessee, for purposes of Condemnation only, shall be considered the property of the Lessee and Lessee shall be entitled to any and all compensation which is payable therefor. In the event that this Lease is not terminated by reason of the Condemnation, Lessor shall repair any damage to the Premises caused by such Condemnation.

15. Brokerage Fees.

15.1 Intentionally omitted.

15.2 Intentionally omitted.

15.3 **Representations and Indemnities of Broker Relationships**. Lessee and Lessor each represent and warrant to the other that it has had no dealings with any person, firm, broker, agent or finder (other than the Brokers and Agents, if any) in connection with this Lease, and that no one other than said named Brokers and Agents is entitled to any commission or finder's fee in connection herewith. Lessee and Lessor do each hereby agree to indemnify, protect, defend and hold the other harmless from and against liability for compensation or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying Party, including any costs, expenses, attorneys' fees reasonably incurred with respect thereto.

16. Estoppel Certificates.

(a) Each Party (as "**Responding Party**") shall within 10 days after written notice from the other Party (the "**Requesting Party**") execute, acknowledge and deliver to the Requesting Party a statement in writing in form similar to the then most current "**Estoppel Certificate**" form published BY AIR CRE, plus such additional information, confirmation and/or statements as may be reasonably requested by the Requesting Party.

(b) If the Responding Party shall fail to execute or deliver the Estoppel Certificate within such 10 day period, the Requesting Party may execute an Estoppel Certificate stating that: (i) the Lease is in full force and effect without modification except as may be represented by the Requesting Party, (ii) there are no uncured defaults in the Requesting Party's performance, and (iii) if Lessor is the Requesting Party, not more than one month's rent has been paid in advance. Prospective purchasers and encumbrancers may rely upon the Requesting Party's Estoppel Certificate, and the Responding Party shall be estopped from denying the truth of the facts contained in said Certificate. In addition, Lessee acknowledges that any failure on its part to provide such an Estoppel Certificate will expose Lessor to risks and potentially cause Lessor to incur costs not contemplated by this Lease, the extent of which will be extremely difficult to ascertain. Accordingly, should the Lessee fail to execute and/or deliver a requested Estoppel Certificate in a timely fashion the monthly Base Rent shall be automatically increased, without any requirement for notice to Lessee, by an amount equal to 10% of the then existing Base Rent or $100, whichever is greater until Lessee delivers an executed Estoppel Certificate to Lessor. The Parties agree that such increase in Base Rent represents fair and reasonable compensation for the additional risk/costs that Lessor will incur by reason of Lessee's failure to provide the Estoppel Certificate. Such increase in Base Rent shall in no event constitute a waiver of Lessee's Default or Breach with respect to the failure to provide the Estoppel Certificate nor prevent the exercise of any of the other rights and remedies granted hereunder.

(c) If Lessor desires to finance, refinance, or sell the Premises, or any part thereof, Lessee and all Guarantors shall within 10 days after written notice from Lessor deliver to any potential lender or purchaser designated by Lessor such financial statements as may be reasonably required by such lender or purchaser, including but not limited to Lessee's financial statements for the past 3 years. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. Definition of Lessor. The term "**Lessor**" as used herein shall mean the owner or owners at the time in question of the fee title to the Premises, or, if this is a sublease, of the Lessee's interest in the prior lease. In the event of a transfer of Lessor's title or interest in the Premises or this Lease, Lessor shall deliver to the transferee or assignee (in cash or by credit) any unused Security Deposit held by Lessor. Upon such transfer or assignment and delivery of the Security Deposit, as aforesaid, the prior Lessor shall be relieved of all liability with respect to the obligations and/or covenants under this Lease thereafter to be performed by the Lessor. Subject to the foregoing, the obligations and/or covenants in this Lease to be performed by the Lessor shall be binding only upon the Lessor as hereinabove defined.

18. Severability. The invalidity of any provision of this Lease, as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

19. Days. Unless otherwise specifically indicated to the contrary, the word "**days**" as used in this Lease shall mean and refer to calendar days.

20. Limitation on Liability. The obligations of Lessor under this Lease shall not constitute personal obligations of Lessor, or its partners, members, directors, officers or shareholders, and Lessee shall look to the Premises, including insurance and/or sales proceeds, and to no other assets of Lessor, for the satisfaction of any liability of Lessor with respect to this Lease, and shall not seek recourse against Lessor's partners, members, directors, officers or shareholders, or any of their personal assets for such satisfaction.

21. Time of Essence. Time is of the essence with respect to the performance of all obligations to be performed or observed by the Parties under this Lease.

22. No Prior or Other Agreements. This Lease contains all agreements between the Parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective.

23. Notices.

23.1 **Notice Requirements**. All notices required or permitted by this Lease or applicable law shall be in writing and may be delivered in person (by hand or by courier) or may be sent by regular, certified or registered mail or U.S. Postal Service Express Mail, with postage prepaid, or by facsimile transmission, or by email, and shall be deemed sufficiently given if served in a manner specified in this Paragraph 23. The addresses noted adjacent to a Party's signature on this Lease shall be that Party's address for delivery or mailing of notices. Either Party may by written notice to the other specify a different address for notice, except that upon Lessee's taking possession of the Premises, the Premises shall constitute Lessee's address for notice. A copy of all notices to Lessor shall be concurrently transmitted to such party or parties at such addresses as Lessor may from time to time hereafter designate in writing.

23.2 **Date of Notice**. Any notice sent by registered or certified mail, return receipt requested, shall be deemed given on the date of delivery shown on the receipt card, or if no delivery date is shown, the postmark thereon. If sent by regular mail the notice shall be deemed given 72 hours after the same is addressed as required herein and mailed with postage prepaid. Notices delivered by United States Express Mail or overnight courier that guarantees next day delivery shall be deemed given 24 hours after delivery of the same to the Postal Service or courier. Notices delivered by hand, or transmitted by facsimile transmission or by email shall be deemed delivered upon actual receipt. If notice is received on a Saturday, Sunday or legal holiday, it shall be deemed received on the next business day.

23.3 **Options.** Notwithstanding the foregoing, in order to exercise any Options (see paragraph 39), the Notice must be sent by Certified Mail (return receipt requested), Express Mail (signature required), courier (signature required) or some other methodology that provides a receipt establishing the date the notice was received by the Lessor.

24. Waivers.

(a) No waiver by Lessor of the Default or Breach of any term, covenant or condition hereof by Lessee, shall be deemed a waiver of any other term, covenant or condition hereof, or of any subsequent Default or Breach by Lessee of the same or of any other term, covenant or condition hereof. Lessor's consent to, or approval of, any act shall not be deemed to render unnecessary the obtaining of Lessor's consent to, or approval of, any subsequent or similar act by Lessee, or be construed as the basis of an estoppel to enforce the provision or provisions of this Lease requiring such consent.

(b) The acceptance of Rent by Lessor shall not be a waiver of any Default or Breach by Lessee. Any payment by Lessee may be accepted by Lessor on account of monies or damages due Lessor, notwithstanding any qualifying statements or conditions made by Lessee in connection therewith, which such statements and/or conditions shall be of no force or effect whatsoever unless specifically agreed to in writing by Lessor at or before the time of deposit of such payment.

(c) THE PARTIES AGREE THAT THE TERMS OF THIS LEASE SHALL GOVERN WITH REGARD TO ALL MATTERS RELATE THERETO AND HEREBY WAIVE THE PROVISIONS OF ANY PRESENT OR FUTURE STATUTE TO THE EXTENT THAT SUCH STATUTE IS INCONSISTENT WITH THIS LEASE

25. Disclosures Regarding The Nature of a Real Estate Agency Relationship.

(a) When entering into a discussion with a real estate agent regarding a real estate transaction, a Lessor or Lessee should from the outset understand what type of agency relationship or representation it has with the agent or agents in the transaction. Lessor and Lessee acknowledge being advised by the Brokers in this transaction, as follows:

(i) *Lessor's Agent*. A Lessor's agent under a listing agreement with the Lessor acts as the agent for the Lessor only. A Lessor's agent or subagent has the following affirmative obligations: *To the Lessor*: A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Lessor. *To the Lessee and the Lessor*: (a) Diligent exercise of reasonable skills and care in performance of the agent's duties. (b) A duty of honest and fair dealing and good faith. (c) A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(ii) *Lessee's Agent*. An agent can agree to act as agent for the Lessee only. In these situations, the agent is not the Lessor's agent, even if by agreement the agent may receive compensation for services rendered, either in full or in part from the Lessor. An agent acting only for a Lessee has the following affirmative obligations. *To the Lessee*: A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Lessee. *To the Lessee and the Lessor*: (a) Diligent exercise of reasonable skills and care in performance of the agent's duties. (b) A duty of honest and fair dealing and good faith. (c) A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(iii) *Agent Representing Both Lessor and Lessee*. A real estate agent, either acting directly or through one or more associate licenses, can legally be the agent of both the Lessor and the Lessee in a transaction, but only with the knowledge and consent of both the Lessor and the Lessee. In a dual agency situation, the agent has the following affirmative obligations to both the Lessor and the Lessee: (a) A fiduciary duty of utmost care, integrity, honesty and loyalty in the dealings with either Lessor or the Lessee. (b) Other duties to the Lessor and the Lessee as stated above in subparagraphs (i) or (ii). In representing both Lessor and Lessee, the agent may not, without the express permission of the respective Party, disclose to the other Party confidential information, including, but not limited to, facts relating to either Lessee's or Lessor's financial position, motivations, bargaining position, or other personal information that may impact rent, including Lessor's willingness to accept a rent less than the listing rent or Lessee's willingness to pay rent greater than the rent offered. The above duties of the agent in a real estate transaction do not relieve a Lessor or Lessee from the responsibility to protect their own interests. Lessor and Lessee should carefully read all agreements to assure that they adequately express their understanding of the transaction. A real estate agent is a person qualified to advise about real estate. If legal or tax advice is desired, consult a competent professional. Both Lessor and Lessee should strongly consider obtaining tax advice from a competent professional because the federal and state tax consequences of a transaction can be complex and subject to change.

26. No Right To Holdover. Lessee has no right to retain possession of the Premises or any part thereof beyond the expiration or termination of this Lease. In the event that Lessee holds over, then the Base Rent shall be increased to 125% of the Base Rent applicable immediately preceding the expiration or termination for the first full or partial month of such holding over, and increased to 150% of the Base Rent applicable immediately preceding the expiration or termination for any period of holding over in excess of 30 days.

Holdover Base Rent shall be calculated on monthly basis. Nothing contained herein shall be construed as consent by Lessor to any holding over by Lessee.

27. Cumulative Remedies. No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at law or in equity.

28. Covenants and Conditions; Construction of Agreement. All provisions of this Lease to be observed or performed by Lessee are both covenants and conditions. In construing this Lease, all headings and titles are for the convenience of the Parties only and shall not be considered a part of this Lease. Whenever required by the context, the singular shall include the plural and vice versa. This Lease shall not be construed as if prepared by one of the Parties, but rather according to its fair meaning as a whole, as if both Parties had prepared it.

29. Binding Effect; Choice of Law. This Lease shall be binding upon the Parties, their personal representatives, successors and assigns and be governed by the laws of the State in which the Premises are located. Any litigation between the Parties hereto concerning this Lease shall be initiated in the county in which the Premises are located.

30. Subordination; Attornment; Non-Disturbance.

30.1 **Subordination**. This Lease and any Option granted hereby shall be subject and subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively, "**Security Device**"), now or hereafter placed upon the Premises, to any and all advances made on the security thereof, and to all renewals, modifications, and extensions thereof. Lessee agrees that the holders of any such Security Devices (in this Lease together referred to as "**Lender**") shall have no liability or obligation to perform any of the obligations of Lessor under this Lease. Any Lender may elect to have this Lease and/or any Option granted hereby superior to the lien of its Security Device by giving written notice thereof to Lessee, whereupon this Lease and such Options shall be deemed prior to such Security Device, notwithstanding the relative dates of the documentation or recordation thereof.

30.2 **Attornment**. In the event that Lessor transfers title to the Premises, or the Premises are acquired by another upon the foreclosure or termination of a Security Device to which this Lease is subordinated (i) Lessee shall, subject to the non-disturbance provisions of Paragraph 30.3, attorn to such new owner, and upon request, enter into a new lease, containing all of the terms and provisions of this Lease, with such new owner for the remainder of the term hereof, or, at the election of the new owner, this Lease will automatically become a new lease between Lessee and such new owner, and (ii) Lessor shall thereafter be relieved of any further obligations hereunder and such new owner shall assume all of Lessor's obligations, except that such new owner shall not: (a) be liable for any act or omission of any prior lessor or with respect to events occurring prior to acquisition of ownership; (b) be subject to any offsets or defenses which Lessee might have against any prior lessor, (c) be bound by prepayment of more than one month's rent, or (d) be liable for the return of any security deposit paid to any prior lessor which was not paid or credited to such new owner.

30.3 **Non-Disturbance**. With respect to Security Devices entered into by Lessor after the execution of this Lease, Lessee's subordination of this Lease shall be subject to receiving a commercially reasonable non-disturbance agreement (a "**Non-Disturbance Agreement**") from the Lender which Non-Disturbance Agreement provides that Lessee's possession of the Premises, and this Lease, including any options to extend the term hereof, will not be disturbed so long as Lessee is not in Breach hereof and attorns to the record owner of the Premises. Further, within 60 days after the execution of this Lease, Lessor shall use its commercially reasonable efforts to obtain a Non-Disturbance Agreement from the holder of any pre-existing Security Device which is secured by the Premises. In the event that Lessor is unable to provide the Non-Disturbance Agreement within said 60 days, then Lessee may, at Lessee's option, directly contact Lender and attempt to negotiate for the execution and delivery of a Non-Disturbance Agreement.

30.4 **Self-Executing**. The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents; provided, however, that, upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of the Premises, Lessee and Lessor shall execute such further writings as may be reasonably required to separately document any subordination, attornment and/or Non-Disturbance Agreement provided for herein.

31. Attorneys' Fees. If any Party brings an action or proceeding involving the Premises whether founded in tort, contract or equity, or to declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorneys' fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term, "**Prevailing Party**" shall include, without limitation, a Party who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party of its claim or defense. The attorneys' fees award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. In addition, Lessor shall be entitled to attorneys' fees, costs and expenses incurred in the preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach ($200 is a reasonable minimum per occurrence for such services and consultation).

32. Lessor's Access; Showing Premises; Repairs. Lessor and Lessor's agents shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times after reasonable prior notice for the purpose of showing the same to prospective purchasers, lenders, appraisers or tenants, and making such alterations, repairs, improvements or additions to the Premises as Lessor may deem necessary or desirable and the erecting, using and maintaining of utilities, services, pipes and conduits through the Premises and/or other premises as long as there is no material adverse effect on Lessee's use of the Premises. 24 hours shall be considered reasonable notice for purposes of this Paragraph 32. All such activities shall be without abatement of rent or liability to Lessee.

33. Auctions. Lessee shall not conduct, nor permit to be conducted, any auction upon the Premises without Lessor's prior written consent. Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to permit an auction.

34. Signs. Lessor may place on the Premises ordinary "For Sale" signs at any time and ordinary "For Lease" signs during the last 12 months of the term hereof. Lessee shall not place any sign upon the Premises without Lessor's prior written consent. All signs must comply with all Applicable Requirements.

35. Termination; Merger. Unless specifically stated otherwise in writing by Lessor, the voluntary or other surrender of this Lease by Lessee, the mutual termination or cancellation hereof, or a termination hereof by Lessor for Breach by Lessee, shall automatically terminate any sublease or lesser estate in the Premises; provided, however, that Lessor may elect to continue any one or all existing subtenancies. Lessor's failure within 10 days following any such event to elect to the contrary by written notice to the holder of any such lesser interest, shall constitute Lessor's election to have such event constitute the termination of such interest.

36. Consents. All requests for consent shall be in writing. Except as otherwise provided herein, wherever in this Lease the consent of a Party is required to an act by or for the other Party, such consent shall not be unreasonably withheld conditioned or delayed. Lessor's actual reasonable costs and expenses (including but not limited to architects', attorneys', engineers' and other consultants' fees) incurred in the consideration of, or response to, a request by Lessee for any Lessor consent, including but not limited to consents to an assignment, a subletting or the presence or use of a Hazardous Substance, shall be paid by Lessee upon receipt of an invoice and supporting documentation therefor. Lessor's consent to any act, assignment or subletting shall not constitute an acknowledgment that no Default or Breach by Lessee of this Lease exists, nor shall such consent be deemed a waiver of any then existing Default or Breach, except as may be otherwise specifically stated in writing by Lessor at the time of such consent. The failure to specify herein any

particular condition to Lessor's consent shall not preclude the imposition by Lessor at the time of consent of such further or other conditions as are then reasonable with reference to the particular matter for which consent is being given. In the event that either Party disagrees with any determination made by the other hereunder and reasonably requests the reasons for such determination, the determining party shall furnish its reasons in writing and in reasonable detail within 10 business days following such request.

37.Guarantor. Intentionally omitted.

38.Quiet Possession. Subject to payment by Lessee of the Rent and performance of all of the covenants, conditions and provisions on Lessee's part to be observed and performed under this Lease, Lessee shall have quiet possession and quiet enjoyment of the Premises during the term hereof.

39. Options. If Lessee is granted any Option, as defined below, then the following provisions shall apply.

39.1 **Definition**. "**Option**" shall mean: (a) the right to extend or reduce the term of or renew this Lease or to extend or reduce the term of or renew any lease that Lessee has on other property of Lessor; (b) the right of first refusal or first offer to lease either the Premises or other property of Lessor; (c) the right to purchase, the right of first offer to purchase or the right of first refusal to purchase the Premises or other property of Lessor.

39.2 **Options Personal To Original Lessee**. Any Option granted to Lessee in this Lease is personal to the original Lessee, and cannot be assigned or exercised by anyone other than said original Lessee or Lessee Affiliate and only while the original Lessee and/or Lessee Affiliate is in full possession of the Premises and, if requested by Lessor, with Lessee certifying that Lessee has no intention of thereafter assigning or subletting.

39.3 **Multiple Options**. In the event that Lessee has any multiple Options to extend or renew this Lease, a later Option cannot be exercised unless the prior Options have been validly exercised.

39.4 **Effect of Default on Options**.

(a) Lessee shall have no right to exercise an Option: (i) during the period commencing with the giving of any notice of Default and continuing until said Default is cured, (ii) during the period of time any Rent is unpaid (without regard to whether notice thereof is given Lessee), (iii) during the time Lessee is in Breach of this Lease, or (iv) in the event that Lessee has been given 3 or more notices of separate Default, whether or not the Defaults are cured, during the 12 month period immediately preceding the exercise of the Option.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 39.4(a).

(c) An Option shall terminate and be of no further force or effect, notwithstanding Lessee's due and timely exercise of the Option, if, after such exercise and prior to the commencement of the extended term or completion of the purchase, (i) Lessee fails to pay Rent for a period of 30 days after such Rent becomes due (without any necessity of Lessor to give notice thereof), or (ii) if Lessee commits a Breach of this Lease.

40. Multiple Buildings. If the Premises are a part of a group of buildings controlled by Lessor, Lessee agrees that it will abide by and conform to all reasonable rules and regulations which Lessor may make from time to time for the management, safety, and care of said properties, including the care and cleanliness of the grounds and including the parking, loading and unloading of vehicles, and to cause its employees, suppliers, shippers, customers, contractors and invitees to so abide and conform. Lessee also agrees to pay its fair share of common expenses incurred in connection with such rules and regulations.

41. Security Measures. Lessee hereby acknowledges that the Rent payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of the Premises, Lessee, its agents and invitees and their property from the acts of third parties.

42. Reservations. Lessor reserves to itself the right, from time to time, to grant, without the consent or joinder of Lessee, such easements, rights and dedications that Lessor deems necessary, and to cause the recordation of parcel maps and restrictions, so long as such easements, rights, dedications, maps and restrictions do not unreasonably interfere with the use of the Premises by Lessee. Lessee agrees to sign any documents reasonably requested by Lessor to effectuate any such easement rights, dedication, map or restrictions.

43. Performance Under Protest. If at any time a dispute shall arise as to any amount or sum of money to be paid by one Party to the other under the provisions hereof, the Party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment and there shall survive the right on the part of said Party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said Party to pay such sum or any part thereof, said Party shall be entitled to recover such sum or so much thereof as it was not legally required to pay. A Party who does not initiate suit for the recovery of sums paid "under protest" within 6 months shall be deemed to have waived its right to protest such payment.

44. Authority; Multiple Parties; Execution.

(a) If either Party hereto is a corporation, trust, limited liability company, partnership, or similar entity, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on its behalf. Each Party shall, within 30 days after request, deliver to the other Party satisfactory evidence of such authority.

(b) If this Lease is executed by more than one person or entity as "Lessee", each such person or entity shall be jointly and severally liable hereunder. It is agreed that any one of the named Lessees shall be empowered to execute any amendment to this Lease, or other document ancillary thereto and bind all of the named Lessees, and Lessor may rely on the same as if all of the named Lessees had executed such document.

(c) This Lease may be executed by the Parties in counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument.

45. Conflict. Any conflict between the printed provisions of this Lease and the typewritten or handwritten provisions shall be controlled by the typewritten or handwritten provisions.

46. Offer. Preparation of this Lease by either Party or their agent and submission of same to the other Party shall not be deemed an offer to lease to the other Party. This Lease is not intended to be binding until executed and delivered by all Parties hereto.

47. Amendments. This Lease may be modified only in writing, signed by the Parties in interest at the time of the modification. As long as they do not materially change Lessee's obligations hereunder, Lessee agrees to make such reasonable non-monetary modifications to this Lease as may be reasonably required by a Lender in connection with the obtaining of normal financing or refinancing of the Premises.

48. Waiver of Jury Trial. THE PARTIES HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING INVOLVING THE PROPERTY OR ARISING OUT OF THIS AGREEMENT.

49. Arbitration of Disputes. An Addendum requiring the Arbitration of all disputes between the Parties and/or Brokers arising out of this Lease ☐ is ☒ is not attached to this Lease.

50. Accessibility; Americans with Disabilities Act.

(a) The Premises:

☒ have not undergone an inspection by a Certified Access Specialist (CASp). Note: A Certified Access Specialist (CASp) can inspect the subject premises and determine whether the subject premises comply with all of the applicable construction-related accessibility standards under state law. Although state law does not require a CASp inspection of the subject premises, the commercial property owner or lessor may not prohibit the lessee or tenant from obtaining a CASp inspection of the subject premises for the occupancy or potential occupancy of the lessee or tenant, if requested by the lessee or tenant. The parties shall mutually agree on the arrangements for the time and manner of the CASp inspection, the payment of the fee for the CASp inspection, and the cost of making any repairs necessary to correct violations of construction-related accessibility standards within the premises.

☐ have undergone an inspection by a Certified Access Specialist (CASp) and it was determined that the Premises met all applicable construction-related accessibility standards pursuant to California Civil Code §55.51 et seq. Lessee acknowledges that it received a copy of the inspection report at least 48 hours prior to executing this Lease and agrees to keep such report confidential.

☐ have undergone an inspection by a Certified Access Specialist (CASp) and it was determined that the Premises did not meet all applicable construction-related accessibility standards pursuant to California Civil Code §55.51 et seq. Lessee acknowledges that it received a copy of the inspection report at least 48 hours prior to executing this Lease and agrees to keep such report confidential except as necessary to complete repairs and corrections of violations of construction related accessibility standards.

In the event that the Premises have been issued an inspection report by a CASp the Lessor shall provide a copy of the disability access inspection certificate to Lessee within 7 days of the execution of this Lease.

(b) Since compliance with the Americans with Disabilities Act (ADA) and other state and local accessibility statutes are dependent upon Lessee's specific use of the Premises, except as set forth at Paragraph 2.3 of this Lease, Lessor makes no warranty or representation as to whether or not the Premises comply with ADA or any similar legislation. In the event that Lessee's specific and single use of the Premises requires modifications or additions to the Premises in order to be in compliance with ADA or other accessibility statutes, Lessee agrees to make any such necessary modifications and/or additions at Lessee's expense.

LESSOR AND LESSEE HAVE CAREFULLY READ AND REVIEWED THIS LEASE AND EACH TERM AND PROVISION CONTAINED HEREIN, AND BY THE EXECUTION OF THIS LEASE SHOW THEIR INFORMED AND VOLUNTARY CONSENT THERETO. THE PARTIES HEREBY AGREE THAT, AT THE TIME THIS LEASE IS EXECUTED, THE TERMS OF THIS LEASE ARE COMMERCIALLY REASONABLE AND EFFECTUATE THE INTENT AND PURPOSE OF LESSOR AND LESSEE WITH RESPECT TO THE PREMISES.

ATTENTION: NO REPRESENTATION OR RECOMMENDATION IS MADE BY AIR CRE OR BY ANY BROKER AS TO THE LEGAL SUFFICIENCY, LEGAL EFFECT, OR TAX CONSEQUENCES OF THIS LEASE OR THE TRANSACTION TO WHICH IT RELATES. THE PARTIES ARE URGED TO:

1. SEEK ADVICE OF COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS LEASE.

2. RETAIN APPROPRIATE CONSULTANTS TO REVIEW AND INVESTIGATE THE CONDITION OF THE PREMISES. SAID INVESTIGATION SHOULD INCLUDE BUT NOT BE LIMITED TO: THE POSSIBLE PRESENCE OF HAZARDOUS SUBSTANCES, THE ZONING OF THE PREMISES, THE STRUCTURAL INTEGRITY, THE CONDITION OF THE ROOF AND OPERATING SYSTEMS, AND THE SUITABILITY OF THE PREMISES FOR LESSEE'S INTENDED USE.

WARNING: IF THE PREMISES ARE LOCATED IN A STATE OTHER THAN CALIFORNIA, CERTAIN PROVISIONS OF THE LEASE MAY NEED TO BE REVISED TO COMPLY WITH THE LAWS OF THE STATE IN WHICH THE PREMISES ARE LOCATED.

The parties hereto have executed this Lease at the place and on the dates specified above their respective signatures.

Executed at: Santa Barbara, CA
On: 6/20/19

By LESSOR:
Raf PACIFICA GROUP - REAL ESTATE FUND IV, LLC, a California limited liability company

By: /s/ Steven C. Leonard
Name Printed: Steven C. Leonard
Title: Manager
Phone: _____
Fax: _____
Email: _____

APG HOLLYWOOD CENTER, LLC, a California limited liability company

By: K Associates,
a California general partnership
Its: sole and Managing Member

By: /s/ Michael B. Kaplan
Name Printed: Michael B. Kaplan

Executed at: Goleta, CA
On: 6/19/19

By LESSEE:
INOGEN, INC., a Delaware corporation

By: /s/ Scott Wilkinson
Name Printed: Scott Wilkinson
Title: President Phone: _____
Fax: _____
Email: _____

By: /s/ Alison Bauerlein
Name Printed: Alison Bauerlein
Title: Secretary
Phone: _____
Fax: _____
Email: _____

Address: 326 Bollay Drive
Goleta, CA 93117
Federal ID No.:

Title: Managing General Partner
Phone: _____
Fax: _____
Email: _____

Address: 111 C Street, Suite 200
Encinitas, CA 92024
Federal ID No.: _____

APG AIRPORT FREEWAY CENTER, a
California limited liability company

By: K Associates,
a California general partnership
Its: sole and Managing Member

By: /s/ Michael B. Kaplan
Name: Michael B. Kaplan
Its: Managing General Partner

BROKER

Hayes Commercial Group

Attn: Christos Celmayster
Title: Partner

Address: 222 East Carrillo Street
Suite 101
Santa Barbara, CA 93101
Phone: (805) 898-4388
Fax: _____
Email: christos@hayescommercial.com
Federal ID No.: 90-1141127
Broker/AGENT DRE License #: 02017017

BROKER

Hayes Commercial Group/CBRE

Attn: Francois DeJohn/Dennis J. Hearst
Title: _____

Address: _____
Phone: _____
Fax: _____
Email: fran@hayescommercial.com /
dennis.hearst@cbre.com
Federal ID No.: 90-1141127
Broker/AGENT DRE License #: 02017017
CBRE DRE License #: 004099

RENT ADJUSTMENT(S)
STANDARD LEASE ADDENDUM

Dated: June 19, 2019
By and Between
Lessor: RAF PACIFICA GROUP - REAL ESTATE FUND IV, LLC, a California limited liability company; APG HOLLYWOOD CENTER, LLC, a California limited liability company; and APG AIRPORT FREEWAY CENTER, LLC, a California limited liability company
Lessee: INOGEN, INC., a Delaware corporation
Property Address: 301 Coromar Drive, Goleta, CA
(street address, city, state, zip)

Paragraph: 51

A. RENT ADJUSTMENTS:

The monthly rent for each month of the adjustment period(s) specified below shall be increased using the method(s) indicated below:
(Check Method(s) to be Used and Fill in Appropriately)

☒ **I. Cost of Living Adjustment(s) (COLA)**

a. On (Fill in COLA Dates): Months 15, 27, 39, 51, 63, 75, 87, 99, and 111 of the Original Term the Base Rent shall be adjusted by the change, if any, from the Base Month specified below, in the Consumer Price Index of the Bureau of Labor Statistics of the U.S. Department of Labor for (select one): ☐ CPI W (Urban Wage Earners and Clerical Workers) or ☒ CPI U (All Urban Consumers), for (Fill in Urban Area): Los Angeles - Long Beach - Anaheim, CA, All Items (1982-1984 = 100), herein referred to as "CPI".

b. The monthly Base Rent payable in accordance with paragraph A.I.a. of this Addendum shall be calculated as follows: the Base Rent set forth in paragraph 1.5 of the attached Lease, shall be multiplied by a fraction the numerator of which shall be the CPI of the calendar month 2 months prior to the month(s) specified in paragraph A.I.a. above during which the adjustment is to take effect, and the denominator of which shall be the CPI of the calendar month which is 2 months prior to (select one): the ☒ first month of the term of this Lease as set forth in paragraph 1.3 ("Base Month") or ☐ (Fill in Other "Base Month"): _____. The sum so calculated shall constitute the new monthly Base Rent hereunder, but in no event, shall any such new monthly Base Rent be less than the Base Rent payable for the month immediately preceding the Base Rent adjustment nor increase more than three and one-half percent (3.5%) on an annual, cumulative basis over the Base Month.

c. In the event the compilation and/or publication of the CPI shall be transferred to any other governmental department or bureau or agency or shall be discontinued, then the index most nearly the same as the CPI shall be used to make such calculation. In the event that the Parties cannot agree on such alternative index, then the matter shall be submitted for decision to the American Arbitration Association in accordance with the then rules of said Association and the decision of the arbitrators shall be binding upon the parties. The cost of said Arbitration shall be paid equally by the Parties.

AIRCRE

OPTION(S) TO EXTEND
STANDARD LEASE ADDENDUM

Dated: June 19, 2019
By and Between
Lessor: RAF PACIFICA GROUP - REAL ESTATE FUND IV, LLC, a California limited liability company; APG HOLLYWOOD CENTER, LLC, a California limited liability company; and APG AIRPORT FREEWAY CENTER, LLC, a California limited liability company
Lessee: INOGEN, INC., a Delaware corporation
Property Address: 301 Coromar Drive, Goleta, CA
(street address, city, state, zip)

Paragraph: 52

A. OPTION(S) TO EXTEND:
Lessor hereby grants to Lessee the option to extend the term of this Lease for two (2) additional sixty (60) month period(s) commencing when the prior term expires (the first 60-month period shall be referred to herein as "Option 1"
and the second 60-month period shall be referred to herein as "Option 2") upon each and all of the following terms and conditions:

(i) In order to exercise an option to extend, Lessee must give written notice of such election to Lessor and Lessor must receive the same at least 12 but not more than 18 months prior to the date that the option period would commence, time being of the essence, or such earlier period of time as is necessary for Lessee to exercise its rights under Paragraph
2.3(b). If proper notification of the exercise of an option is not given and/or received, such option shall automatically expire.
Options (if there are more than one) may only be exercised consecutively.

(ii) The provisions of paragraph 39, including those relating to Lessee's Default set forth in paragraph 39.4 of this Lease, are conditions of this Option.

(iii) Except for the provisions of this Lease granting an option or options to extend the term, all of the terms and conditions of this Lease except where specifically modified by this option shall apply.

(iv) This Option is personal to the original Lessee, and cannot be assigned or exercised by anyone other than said original Lessee or Lessee Affiliate and only while the original Lessee and/or Lessee Affiliate is in full possession of the Premises and without the intention of thereafter assigning or subletting.

(v) The monthly rent for each month of the option period shall be calculated as follows, using the method(s) indicated below: (Check Method(s) to be Used and Fill in Appropriately)

☒ **I. Cost of Living Adjustment(s) (COLA)** (Option 2)

a. On (Fill in COLA Dates): Months 183, 195, 207, 219 and 231 of the term the Base Rent shall be adjusted by the change, if any, from the Base Month specified below, in the Consumer Price Index of the Bureau of Labor Statistics of the U.S. Department of Labor for (select one):☐ CPI W (Urban Wage Earners and Clerical Workers) or ☒ CPI U (All Urban Consumers), for (Fill in Urban Area): Los Angeles - Long Beach - Anaheim, CA. All Items (1982-1984 = 100), herein referred to as "CPI".

b. The monthly Base Rent payable in accordance with paragraph A.I.a. of this Addendum shall be calculated as follows: the Base Rent for month 123 of the term (as determined pursuant to paragraph A.II.a. of this Addendum), shall be multiplied by a fraction the numerator of which shall be the CPI of the calendar month 2 months prior to the month(s) specified in paragraph A.I.a. above during which the adjustment is to take effect, and the denominator of which shall be the CPI of the calendar month which is 2 months prior to (select one): the first month of the term of this Lease as set forth in paragraph 1.3 ("Base Month") or (Fill in Other "Base Month"): Month 123 of the term (i.e., month 121 of the term). The sum so calculated shall constitute the new monthly Base Rent hereunder, but in no event, shall any such new monthly Base Rent be less than the Base Rent payable for the month immediately preceding the rent adjustment nor increase more than three and one-half percent (3.5%) on an annual, cumulative basis over the Base Month.

c. In the event the compilation and/or publication of the CPI shall be transferred to any other governmental department or bureau or agency or shall be discontinued, then the index most nearly the same as the CPI shall be used to make such calculation. In the event that the Parties cannot agree on such alternative index, then the matter shall be submitted for decision to the American Arbitration Association in accordance with the then rules of said Association and the decision of the arbitrators shall be binding upon the parties. The cost of said Arbitration shall be paid equally by the Parties.

☒ **II. Market Rental Value Adjustment(s) (MRV)** (Option 1)

a. On (Fill in MRV Adjustment Date(s)) Month 123 of the term the Base Rent shall be adjusted to the "Market Rental Value" of the property as follows:

1) Four months prior to each Market Rental Value Adjustment Date described above, the Parties shall attempt to agree

upon what the new MRV will be on the adjustment date. If agreement cannot be reached, within thirty days, then:

(a) Lessor and Lessee shall immediately appoint a mutually acceptable appraiser or broker to establish the new MRV within the next 30 days. Any associated costs will be split equally between the Parties, or

(b) Both Lessor and Lessee shall each immediately make a reasonable determination of the MRV and submit such determination, in writing, to arbitration in accordance with the following provisions:

(i) Within 15 days thereafter, Lessor and Lessee shall each select an independent third party ☐ appraiser or ☒ broker ("Consultant" - check one) of their choice to act as an arbitrator (Note: the parties may not select either of the Brokers that was involved in negotiating the Lease). The two arbitrators so appointed shall immediately select a third mutually acceptable Consultant to act as a third arbitrator.

(ii) The 3 arbitrators shall within 30 days of the appointment of the third arbitrator reach a decision as to what the actual MRV for the Premises is, and whether Lessor's or Lessee's submitted MRV is the closest thereto. The decision of a majority of the arbitrators shall be binding on the Parties. The submitted MRV which is determined to be the closest to the actual MRV shall thereafter be used by the Parties.

(iii) If either of the Parties fails to appoint an arbitrator within the specified 15 days, the arbitrator timely appointed by one of them shall reach a decision on his or her own, and said decision shall be binding on the Parties.

(iv) The entire cost of such arbitration shall be paid by the party whose submitted MRV is not selected, ie. the one that is NOT the closest to the actual MRV.

2) When determining MRV, the Lessor, Lessee and Consultants shall consider the terms of comparable market transactions for non-renewing lessees for comparable buildings in the Santa Barbara area which shall include, but not limited to, rent, rental adjustments, abated rent, tenant inducements, lease term and financial condition of tenants.

3) Notwithstanding the foregoing, the new Base Rent shall not be less than the rent payable for the month immediately preceding the rent adjustment.

b. Upon the establishment of each New Market Rental Value:

1) the new MRV will become the new "Base Rent" for the purpose of calculating any further Adjustments, and

2) the first month of each Market Rental Value term shall become the new "Base Month" for the purpose of calculating any further Adjustments.

3) On months 135, 147, 159 and 171, the Base Rent shall be adjusted by the change, if any, from the Base Month specified below, in the Consumer Price Index of the Bureau of Labor Statistics of the U.S. Department of Labor for CPI U (All Urban Consumers), for: Los Angeles - Long Beach - Anaheim, CA. All Items (1982-1984=100), hereinafter referred to as "CPI". The monthly Base Rent payable in accordance with this paragraph A.II.b.3 shall be calculated as follows: the Base Rent for month 123 of the term (as determined pursuant to paragraph A.II.a. of this Addendum) shall be multiplied by a fraction, the numerator of which shall be the CPI of the calendar month 2 months prior to the months specified in this paragraph A.II.b.3 above during which the adjustment is to take effect, and the denominator of which shall be the CPI of the calendar month which is 2 months prior to month 123 of the term (i.e., month 121 of the term) ("Base Month"). The sum so calculated shall constitute the new monthly Base Rent hereunder, but in no event, shall any such new monthly Base Rent be less than the Base Rent payable for the month immediately preceding the rent adjustment nor increase more than three and one-half percent (3.5%) on an annual, cumulative basis over the Base Month.

ADDENDUM

TO THAT CERTAIN STANDARD
INDUSTRIAL/COMMERCIAL SINGLE-TENANT LEASE-NET
DATED JUNE 11, 2019, BY AND BETWEEN
RAF PACIFICA GROUP-REAL ESTATE FUND IV, LLC, etc. ("LESSOR")
AND
INOGEN, INC. ("LESSEE")

This Addendum amends the provisions of the above-referenced lease including any attached exhibits or addenda thereto (collectively, the **"Lease"**), it being the intent and agreement that the provisions of the Lease are hereby affirmed by the parties, but, to the extent that the provisions of this Addendum conflict with or differ from the terms of the Lease, the provisions of this Addendum shall control. Capitalized terms not defined herein shall have the definitions that are given to such terms in the Lease.

53. Abatement of Rent.

(a) For so long as Lessee is not in Breach under the terms of this Lease, the Base Rent payable by Lessee shall be fully abated for months one (1) and two (2) of the Original Term. Lessee shall continue to pay Operating Expenses during such abatement period.

(b) The abatements set forth in this Paragraph 53 shall be considered an Inducement Provision subject to the provisions of Paragraph 13.3 of this Lease.

54. Base Building and Lessee Improvements. The Lessor shall construct the Building and site improvements in substantial conformity with the plans prepared by JDO + Associates, job number 2018.13/2019.05 for which the site plan and exterior elevations are attached as **Exhibit A-1** to this Lease (the "**Base Building Improvements**"), at Lessor's sole cost and expense. Lessor shall construct the Base Building Improvements in a good and workmanlike manner and in substantial compliance with all covenants, conditions and restrictions to which the Project is subject and in compliance with all Applicable Requirements.

The Lessor shall also construct the **"Lessee Improvements"** pursuant to the Work Letter attached as **Exhibit B** to the Lease, but specifically excluding any window treatments, data and network cabling and any security alarm system. Other than the work described herein, Lessor shall not be responsible to construct any improvements and shall deliver the Premises in its "AS IS" condition, subject to the warranties set forth in Paragraph 2 of the Lease. The cost of constructing the Lessee Improvements (but not the Base Building Improvements) shall be considered an Inducement Provision, subject to the provisions of Paragraph 13.3 of this Lease.

To the extent that Lessee is liable for performing or arranging for the repair or replacement of any portion of the Premises or Building pursuant to Paragraph 2.3 or Paragraph 7.1 of this Lease following the expiration of the Lessor's warranties set forth in Paragraph 2 of this Lease, Lessor shall assign the Contractor's Warranty (as defined in the Work Letter) and all manufacturers' and/or vendors' equipment warranties; and to the extent that Lessee may request and agree to pay for the cost thereof at Lessee's sole cost and expense, Lessor agrees to cooperate with Lessee, at no additional expense to Lessee, in obtaining any extended warranties reasonably requested by Lessee on any equipment installed as part of the Lessee Improvements. To the extent that any of the foregoing third-party warranties are not assigned to, or otherwise enforceable by, Lessee in accordance with this Paragraph 54, then notwithstanding anything to the contrary in this Lease, Lessor shall be solely responsible for enforcing such third-party warranty obligations following the expiration of the Lessor's warranties set forth in Paragraph 2 of this Lease.

55. Commencement Date and Expiration Date. The Commencement Date shall occur on the later of: (a) **"Substantial Completion"** of the Base Building Improvements and the **"Tenant Improvements"** as those terms are defined in the Work Letter, attached hereto as **Exhibit B,** or (b) November 1, 2020; provided that Lessor shall endeavor to provide Lessee with advance written notice of the actual Commencement Date at least sixty (60) days in advance thereof. If the Commencement Date is on a date other than the first calendar date of a month, then: (i) the Base Rent and Common Area Operating Expenses for the month containing the Commencement Date shall be prorated based upon the ratio that the number of days in the term within such month bears to the total number of days in such month, (ii) the Original Term shall be extended by the number of days from the Commencement Date to the end of the month in which the Commencement Date occurs and (iii) the first twelve month period for purposes of determining Base Rent increases pursuant to Paragraph 51 shall include the month in which the Commencement Date occurs plus the next twelve full calendar months. If the Commencement Date is a date other than as set forth in Paragraph 1.3 of this Lease, within ten days after Lessor has determined the Commencement Date, Lessor may deliver to Lessee a Commencement Date Memorandum in the latest form that is published by the AIR, reciting the actual Commencement Date, Expiration Date, the schedule of adjustments to the Base

Rent and the MRV Adjustment Date (the **"Commencement Date Memorandum"**), which Lessee shall execute and return to Lessor within five (5) business days of the receipt thereof. If Lessee fails to execute and return the Commencement Date Memorandum or respond with comments (if Tenant reasonably disputes the correctness of the information set forth therein) within such time period, the information contained in the Commencement Date Memorandum shall be deemed correct and binding upon Lessee.

The Lessor shall diligently proceed with the construction of the Base Building Improvements and the Lessee Improvements and complete the same and deliver possession of the Premises to Lessee on or before the scheduled Commencement Date as set forth in Paragraph 1.3 of this Lease, provided, however, if there is a Lessee Delay (as defined in the Work Letter attached to this Lease), labor disputes, casualties, government embargo restrictions, shortages of fuel, labor or building materials, action or non-action of public utilities, or of the local, state, or federal governments affecting the Base Building Improvements and/or the Lessee Improvements, or other causes beyond the Lessor's reasonable control, then the scheduled Commencement Date shall be extended for the additional time caused by such delay. Each such delay shall is referred to as an **"Excused Delay"**.

In the event the Commencement Date has not occurred by the scheduled Commencement Date as set forth in Paragraph 1.3 of this Lease, as such date may be extended by any Excused Delay, Lessor shall pay to Lessee a daily penalty in an amount equal to the difference between the holdover rent payable by Lessee for its lease of 326 Bollay Drive, Goleta, CA (the **"Bollay Drive Lease"**) less the rent payable in the final month of the term of such lease, not to exceed $12,571.51 per month, prorated for each day the Commencement Date is delayed (excluding any Excused Delay), up to a maximum total amount of $75,429.30. Lessee shall provide Lessor with a copy of the Bollay Drive lease and such other documentation as reasonably requested by Lessor so that Lessor can calculate and/or verify the amount of the penalty. Lessor shall pay the penalty to Lessee within five (5) days after the end of each calendar month in which the penalty applies.

In the event the Commencement Date has not occurred on or before the date that is twelve (12) months after the scheduled Commencement Date as set forth in Paragraph 1.3 of this Lease, plus up to an additional thirty (30) days for Excused Delays, and provided (i) if and to the extent such delay has not been caused by a Lessee Delay, and (ii) no Default on the part of Lessee then exists, Lessee may, at any time thereafter, elect to terminate this Lease by delivering written notice of such election to Lessor, in which case this Lease shall terminate immediately. In the event that Lessee elects to terminate this Lease in accordance with the preceding sentence, Lessor shall promptly refund the prepaid Rent and Security Deposit previously delivered to Lessor in accordance with Paragraph 1.7(e) of this Lease. Upon Lessor's refund of such amounts following Lessee's timely and effective termination of this Lease, this Lease shall become null and void and Lessee shall have no further interest in the Premises pursuant to the Lease.

56. Verification of Rentable Square Feet of Premises. For purposes of this Lease, "rentable square feet" shall be calculated pursuant to Standard Method of Measuring Floor Area in *Industrial* Buildings (ANSI Z65.2 − 2012) Method A—External Enclosure Method (but excluding major vertical penetrations) (the **"BOMA Standard"**). Within thirty (30) days after the permits have been issued for the Base Building Improvements and Lessee Improvements, Lessor's space planner/architect shall measure the rentable square feet of the Unit in accordance with the BOMA Standard and the results thereof shall be presented and certified by Lessor's architect to Lessee in writing. Lessee's independent space planner/architect may review such determination of the number of rentable square feet of the Unit and Lessee may, within fifteen (15) business days after Lessee's receipt of such determination, reasonably object thereto by written notice to Lessor. Lessee's failure to deliver written notice of such objection within said fifteen (15) business day period shall be deemed to constitute Lessee's acceptance of Lessor's determination of the rentable area of the Unit in accordance with the BOMA Standard. If Lessee timely objects to such determination, Lessor's space planner/architect and Lessee's designated space planner/architect shall promptly meet and attempt to agree upon the rentable square footage of the Unit in accordance with the BOMA Standard. If Lessor's space planner/architect and Lessee's designated space planner/architect cannot agree on the rentable square footage of the Unit within thirty (30) days after Lessee's objection to Lessor's determination, Lessor and Lessee shall mutually select an independent third party space measurement professional to field measure the Unit using the BOMA Standard. Such third party independent measurement professional's determination shall be conclusive and binding on Lessor and Lessee. Lessor and Lessee shall each pay one-half (1/2) of the fees and expenses of the independent third party space measurement professional. In the event that pursuant to the procedure described in this Paragraph 56 above, it is determined that the square footage amounts shall be different from those set forth in Paragraph 1.2 of this Lease, all amounts, percentages and figures appearing or referred to in this Lease based upon such incorrect amount (including, without limitation, the amount of the **"Base Rent," "Lessee's Share"** and the **"Security Deposit"**) shall be modified in accordance with such determination. Lessor's estimated rentable square footage and the Base Rent and Lessee's Share set forth in this Lease shall be utilized until a final determination of rentable square footage is made, whereupon an appropriate adjustment, if necessary, shall be made retroactively, and Lessee or Lessor shall promptly make any appropriate payment to the other party for any accrued underpayment or overpayment of Rent, respectively, as applicable. If such determination is made, it will be confirmed in the Commencement Date Memorandum by Lessor to Lessee.

57. Option to Extend Lease of 289 Coromar Drive. The parties acknowledge that Lessee is currently leasing from Lessor certain premises located at 289 Coromar Drive, Goleta, CA, pursuant to a lease dated December 6, 2018 (the **"289 Coromar Lease"**). In the event that the size of the Premises, as finally determined pursuant to Paragraph 56 above, is determined to be less than 96% of 49,821 rentable square feet, Lessee shall be allowed to extend the term of the 289 Coromar Lease, on the same terms and conditions as set forth therein, until such time as Lessee enters into a lease with Lessor (or Lessor's affiliate) for an additional 5,000 rentable square feet or more at property located at 6759, 6765 or 6789 Navigator Way, Goleta, CA, on terms and conditions acceptable to Lessor and Lessee.

58. Allowance for Installation of Equipment and Wiring. Lessor shall provide an allowance in an amount not to exceed $5.00 per rentable square foot (based on the size of the Premises as finally determined pursuant to Paragraph 56 above) (the **"Allowance"**) for the installation of Lessee's trade fixtures, IT wiring and security system (collectively, **"Allowance Costs"**). Any unused portion of the Allowance for which Lessee has not presented a request for payment in accordance with this Paragraph 58 within six (6) months of Lessor's delivery of the Premises to Lessee shall revert to Lessor. The Allowance shall be paid in progress payments that shall not exceed ninety percent (90%) of the Allowance. The progress payments shall be paid to Lessee on a reimbursement basis within fifteen (15) days after Lessee presents draw requests or invoices that detail the work performed, the percentage of completion and showing that Lessee has incurred design, permitting and/or construction costs constituting Allowance Costs in an amount at least equal to the requested progress payment, but subject to Lessor's inspection to confirm that such work has been performed. Lessor shall not charge a project management fee or supervision fee. The remaining balance of the Allowance shall be payable after completion of all work, and conditioned upon receipt of the following, as applicable:

(i) Lessor's inspection and approval of the work;

(ii) Copies of all paid invoices, including a final summary of all costs for the work;

(iii) An "unconditional waiver and release upon final payment" covering work completed; and

(iv) Copies of signed inspection cards, permits and/or clearances required by all governing agencies, and written proof that all fees relating to the work have been paid by Lessee.

The Allowance shall be considered an Inducement Provision subject to the provisions of Paragraph 13.3 of this Lease.

59. Lessor's Maintenance Obligations. Notwithstanding any provision of this Lease to the contrary, subject to reimbursement pursuant to Paragraph 60 below, Lessor shall maintain, repair and replace as necessary, the landscaping, driveways, parking areas, roof membrane and roof drains, downspouts, gutters and skylights, and exterior of the Building (including painting) at the Premises (collectively, the **"Lessor Maintenance Obligations"**), all so as to keep the same in good order, condition and repair. Except as expressly set forth herein or in the Lease, Lessor shall not have any other obligation to repair or maintain the Premises or the equipment therein.

60. Additional Rent. Lessee shall pay to Lessor during the term hereof, in addition to Base Rent, all Operating Expenses, as hereinafter defined, during each calendar year of the term of the Lease, in accordance with the following provisions:

(a) "Operating Expenses" are defined, for purposes of this Lease, as all costs incurred by Lessor relating to the ownership and operation of the Premises, all calculations, allocations, determinations and decisions in accordance with generally accepted accounting principles (GAAP), consistently applied, including but not limited to, the following:

(i) The cost of those items of Lessor's Maintenance Obligations as set forth at Paragraph 59 above; to the extent that any such item is considered a capital expenditure pursuant to generally accepted accounting principles (GAAP), Lessor shall allocate the cost over the appropriate amortization period (per GAAP) and Lessee shall not be required to pay more than a fraction of the cost, where the fraction equals the number 1 divided by the number of months in the appropriate amortization period, in any given month of the term (as may be extended).

(ii) Any owner's association dues and fees.

(iii) Property management fees in an amount equal to three percent (3.00%) of Base Rent (without taking into account the abatements set forth at Paragraph 53 above) and Operating Expenses.

(iv) Thecost of any environmental inspections that are the obligation of Lessee.

(v) Real Property Taxes (as defined in Paragraph 10).

(vi) Thecost of the premiums for the insurance maintained by Lessor pursuant to Paragraph 8.

(vii) Any deductible portion of an insured loss concerning the Building or the Premises.

(viii) Auditors', accountants' and attorneys' fees and costs related to the ownership and operation of the Premises.

(ix) Any other services to be provided by Lessor that are stated elsewhere in this Lease to be paid by Lessor and reimbursed by Lessee.

(b) The inclusion of the improvements, facilities and services set forth in Subparagraph 60(a) shall not be deemed to impose an obligation upon Lessor to either have said improvements or facilities or to provide those services unless the Premises already has the same as of the Commencement Date, Lessor already provides the services as of the Commencement Date, or Lessor has agreed elsewhere in this Lease to provide the same or some of them.

(c) Operating Expenses are payable monthly on the same day as the Base Rent is due hereunder. The amount of such payments shall be based on Lessor's estimate of the annual Operating Expenses. Within 120 days after the expiration of each calendar year, Lessor shall deliver to Lessee a reasonably detailed statement showing the actual Operating Expenses incurred during the preceding year (a "**Reconciliation**"). If Lessee's payments during such year exceed the actual Operating Expenses, Lessor shall credit the amount of such over-payment against Lessee's next payment of Operating Expenses. If Lessee's payments during such year were less than the actual Operating Expenses, Lessee shall pay to Lessor the amount of deficiency within thirty (30) days after delivery by Lessor to Lessee of the statement.

(d) Lessee shall have the right, at its sole cost and expense, and upon written notice given to Lessor no later than two (2) years after Lessee's receipt of a Reconciliation to make an audit of all of Lessor's bills, records, receipts, insurance certificates and policies relating to Operating Expenses for the preceding calendar year, using the services of a reputable, nationally or regionally prominent operating expense audit firm, which audit firm may be retained by Lessee on a contingency fee basis. Within fifteen (15) business days of Lessor's receipt of such written request of Lessee, Lessor shall make available to Lessee, during normal business hours, at the location where Lessor's books and records are kept, such information as Lessee shall reasonably request. Lessor shall cooperate with Lessee in its explanation of its bills and records. Lessee shall diligently complete any such audit of Operating Expenses and shall deliver to Lessor the written results of such audit within fifteen (15) business days after Lessee receives the same. If Lessor disagrees with the results of Lessee's audit, Lessor and Lessee shall meet and attempt, in good faith, to resolve the dispute. If Lessor and Lessee are unable to resolve the dispute within thirty (30) days after Lessor's receipt of Lessee's audit, then Lessee shall have the right to submit the dispute to arbitration; this right shall be exercised, if at all, by delivering a written notice of election to arbitrate to Lessor not later than thirty (30) days after such failure to resolve. Lessor and Lessee shall agree, within 15 days after Lessee's delivery of the arbitration election, to retain an arbitrator, who shall be a mutually acceptable independent certified public accountant with experience in operating expenses for commercial/industrial buildings in Santa Barbara County, who shall make a determination as to the correct amount of Lessee's share of Operating Expenses. The decision shall be delivered simultaneously to Lessor and Lessee and shall be final and binding on Lessor and Lessee. If the arbitrator determines that the amount of the Operating Expenses billed to the Lessee was incorrect, the appropriate party shall pay to the other party the deficiency or overpayment, as applicable, within thirty (30) days following delivery of the arbitrator's decision, without interest. All costs and expenses of the arbitration shall be paid by Lessee unless the final determination in the arbitration is that Lessor overstated Operating Expenses by more than five percent (5%) of the originally reported Operating Expenses, in which case Lessor shall pay all such costs and expenses of the arbitration. Lessee and its auditor shall keep all of Lessor's records strictly confidential and shall not disclose any information gained from its review of Lessor's records to any third party, except as required by law.

(e) Operating Expenses shall not include:

(i) any expenses paid by Lessee directly to third parties, or as to which Lessor is otherwise reimbursed by any third parties or by warranties or insurance proceeds;

(ii) leasing commissions;

(iii) interest or principal payments or late payment penalties on any mortgage or other indebtedness of Lessor;

(iv) costs and expenses incurred by Lessor in connection with repairs undertaken by Lessor under Paragraphs 9 or 14 (other than the amount of any "deductible" costs incurred in connection with a covered loss);

(v) depreciation charges, except as otherwise stated hereinabove;

(vi) the cost of any capital improvements which are required under any Applicable Requirements which first became applicable to the Building or Project prior to the date of this Lease;

(vii) administrative costs of owning and managing the Project (including, but not limited to, wages, salaries, benefits, office rent and other costs) other than the property management fees expressly provided for herein;

(viii) costs incurred in making upgrades to the Premises not required by governmental laws, regulations or ordinances, except those which are for the purpose of reducing energy costs, maintenance costs or other Operating Expenses;

(ix) cost of insurance premiums for insurance not customarily carried by owners of similar-class office buildings in the area in which the Premises is located;

(x) any costs necessitated by or resulting from the gross negligence of Lessor or its agents;

(xi) tax penalties, interest charges and fines incurred in connection or as a result of Lessor's negligence, inability or willful failure to make tax payments (or to file any tax filings or returns) when due, except to the extent incurred by Lessor in connection with any contest of such taxes;

(xii) reserves, including for future maintenance, repair and/or replacement of improvements; and

(xiii) notwithstanding anything to the contrary herein, capital expenditures on capital improvements or equipment of the Premises shall be limited to the following: (a) those Capital Expenditures expressly permitted to be incurred and amortized at Lessee's expense in accordance with Paragraph 2.3 of this Lease; (b) the cost of capital improvements which are reasonably intended to reduce Operating Expenses to the extent that anticipated savings are reasonably expected to exceed amortization of any such expenditure at the time of implementation; (c) expenditures in connection with Lessor's Maintenance Obligations; and (d) any capital improvements which are required under any Applicable Requirements which are first enacted or enforced following the Commencement Date.

(f) Lessor estimates that the Operating Expenses will initially be $24,870.00 per month. Lessee understands that this is an estimate only and the actual amount may vary from the estimate.

61. Signage. Lessee, with the approval of Lessor (which approval shall not be unreasonably withheld or delayed) pursuant to the Lessor's reasonable sign criteria and subject to the requirements of the City of Goleta and any Applicable Requirements, shall be allowed to install (a) building top signage, (b) exclusive exterior identity signage adjacent to the main entrance to the Building, the exact location and size of any signs to be approved by Lessor, and (c) uppermost signage on any existing or future monument sign at the Premises, which approvals shall not be unreasonably withheld or delayed. Lessee shall be responsible to construct, install and maintain such signage at its sole cost, and shall remove such signage upon expiration or earlier termination of the Lease and repair any damage caused by such removal.

62. Assignment and Subletting. Notwithstanding anything to the contrary in Paragraph 12 of the Lease, the following additional term shall apply to assignment and subletting:

An assignment or subletting of all or a portion of the Premises to an affiliate **("Affiliate")** of Lessee (an entity which is controlled by, controls, or is under common control with, Lessee, or that becomes a parent, successor or affiliate of Lessee, or is a successor of Lessee by reason of merger, consolidation, public offering, reorganization, dissolution, or sale of all or more than an aggregate of fifty percent (50%) of Lessee's stock, membership or partnership interests or assets) shall not be deemed a transfer under Paragraph 12 of this Lease, provided that (i) Lessee notifies Lessor of any such assignment or sublease prior to the effective date thereof and promptly supplies Lessor with any documents or information requested by Lessor regarding such assignment or sublease to such Affiliate (including, in the event of an assignment, evidence of the assignee's assumption of Lessee's obligations under this Lease or, in the event of a sublease, evidence of the sublessee's assumption, in full, of the obligations of Lessee with respect to the portion of the Premises so subleased, other than the payment of rent), (ii) such assignment or sublease is not a subterfuge by Lessee to avoid its obligations under this Lease, (iii) such assignment or sublease does not cause Lessor to be in default under any existing lease at the Building, and (iv) the net worth of such Affiliate is equal to or greater than the net worth of Lessee immediately prior to such transfer as reasonably determined by Lessor after review of financial information for Lessee and such Affiliate. An assignee of Lessee's entire interest in this Lease pursuant to the immediately preceding sentence may be referred to herein as an **"Affiliated Assignee." "Control,"** as used in this Paragraph 62 shall mean the ownership, directly or indirectly, of greater than fifty-one percent (51%) of the voting securities of, or possession of the right to vote, in the ordinary direction of its affairs, of greater than fifty-one percent (51%) of

the voting interest in, an entity. Nothing contained in this Paragraph 62 shall be deemed to release Lessee from its obligations under the Lease.

In the event Lessee sells, sublets, assigns or transfers this Lease, Lessee shall pay to Lessor as additional rent an amount equal to fifty percent (50%) of any consideration received by Lessee in connection with such subletting or assignment and fifty percent (50%) of any Increased Rent (as defined below), less the Costs Component (as defined below), when and as such Increased Rent is received by Lessee. As used in the Paragraph, **"Increased Rent"** shall mean the excess of (i) all rent and other consideration which Lessee is entitled to receive by reason of any sale, sublease, assignment or other transfer of this Lease, over (ii) the rent otherwise payable to Lessee under this Lease at such time. For purposes of the foregoing, any consideration received by Lessee in form other than cash shall be valued at its fair market value as determined by Lessor in good faith. The **"Costs Component"** is that amount which, if paid monthly, would fully amortize on a straight-line basis, over the entire period for which Lessee is to receive Increased Rent, the reasonable costs incurred by Lessee for leasing commissions, tenant improvements and other reasonable expenses incurred in connection with such sublease, assignment or other transfer.

63. Abatement of Rent. If Lessor fails to perform the obligations required of Lessor under this Lease and such failure causes all or a material portion of the Premises to be unusable by Lessee for the Agreed Use because of any failure of Lessor to carry out its Lessor's Maintenance Obligations, or any acts of negligence or willful misconduct of Lessor or any of its agents or employees that interrupts utilities to the Premises, Lessee shall give Lessor notice (the "Lessor Default Notice"), specifying such failure. If Lessor has not remedied that conditions set forth in such Lessor Default Notice within five (5) business days after its receipt thereof, Lessee may, immediately following a second written notice to Lessor notifying Lessor that such abatement is commencing, abate Rent payable under this Lease for that portion of the Premises rendered unusable for the period beginning on the date of delivery of the Lessor Default Notice until the date on which Lessor cures the failure indicated in such Lessor Default Notice.

64. Off-Site Parking. Lessee shall have non-exclusive use of the parking spaces located on Lot 14 of the Project (commonly known as 289 Coromar Drive) in the area shown on **Exhibit D** attached hereto (the **"Additional Parking Area"**), subject to the terms and conditions of this Paragraph 65 and any reasonable rules and regulations hereafter adopted by Lessor. Said parking spaces shall be used for parking by vehicles no larger than full-size passenger automobiles or pick-up trucks, herein called **"Permitted Vehicles."** Lessee may not service or store any vehicles in the Additional Parking Area or park any vehicles overnight in the Additional Parking Area. If Lessee permits or allows any of the prohibited activities described in this Paragraph 65, then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove or tow away the vehicle involved and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor. Other than the foregoing, Lessee's use of such parking spaces shall be free of charge, except that Lessor's operating costs for the Additional Parking Area shall be included in Operating Expenses. The liability insurance that Lessee is required to maintain pursuant to Paragraph 8.3(a) of this Lease shall include coverage for the Additional Parking Area. Lessor reserves the right to terminate Lessee's use such parking spaces upon giving sixty (60) days' written notice to Lessee for the following reasons: (i) Lessor receives governmental approval and commences to redevelop Lot 14, or (ii) Lessor executes a lease with a tenant that leases space in the building(s) located on Lot 14 or any other property controlled by Lessor within the Project that provides that such tenant has the right to park vehicles in the Additional Parking Area.

65. Right of First Offer to Lease. Lessor grants to Lessee a right of first offer (**"First-Offer Right"**) with respect to all other space in the Project owned by Lessor that becomes available for lease during the term of this Lease (**"First-Offer Space"**). Lessee's First-Offer Right shall be on the terms and conditions set forth in this Paragraph 65.

64.1 New Buildings. The First-Offer Right shall begin with respect to buildings not yet constructed (**"New Construction"**) at such times as Lessor receives all permits necessary to commence construction and Lessor is ready to commence construction, but in any event prior to space in any such New Construction being offered to other prospective tenants. Lessee shall only have a First-Offer Right as to New Construction if at least sixty (60) months remain on the term of this Lease, except that Lessee may exercise any remaining Option to Extend (as set forth at Paragraph 52 of this Lease) early if necessary to satisfy this requirement.

64.2 Previously Leased Space. The First-Offer Right shall begin with respect to space that has been previously leased (**"Previously Leased Space"**) only after the expiration or earlier termination of any lease for such space (**"Superior Leases"**), including any renewal, extension or expansion of the Superior Leases (whether or not such renewal or extension is consummated under a lease amendment or a new lease), as long as no renewal, extension or expansion is beyond the rights originally provided in the renewal, extension or expansion provision of the tenant's Superior Lease as of the commencement of such lease. In any event, any Previously Leased Space shall be offered to Lessee before being offered to other prospective tenants. The rights described in this subparagraph 64.2 shall be known collectively as **"Superior Rights."** Lessee shall only have a First-Offer Right as to Previously

Leased Space if at least thirty-six (36) months remain on the term of this Lease, except that Lessee may exercise any remaining Option to Extend (as set forth at Paragraph 52 of this Lease) early if necessary to satisfy this requirement.

64.3 Procedure of Lessor's Offer. Lessor shall provide Lessee with written notice (**"First-Offer Notice"**) from time to time when Lessor determines that any First-Offer Space will become available for lease to third parties. For New Construction, the First-Offer Notice shall be provided at such times as Lessor receives all permits necessary to commence construction and Lessor is ready to commence construction (prior to space in any such New Construction being offered to other prospective tenants). For Previously Leased Space, the Lessor shall provide the First-Offer Notice to Lessee on the later of the date on which Lessor determines that the particular First-Offer Space shall become available for lease or the date that is one hundred eighty (180) days before the First-Offer Space will be available for lease. The First-Offer Notice shall describe in reasonable detail the First-Offer Space that will become available for lease **("Specific First-Offer Space")**. Lessor shall have no liability for unintentionally failing to provide Lessee with a First- Offer Notice, but in such event Lessee's deadline to respond to a Lease Offer as set forth in Paragraph 66 below shall be ten (10) business days as provided in Paragraph 66.

64.4 Procedure for Lessee's Acceptance. If Lessee wishes to exercise Lessee's First-Offer Right with respect to the Specific First-Offer Space, Lessee shall, within ten (10) business days after delivery of the First-Offer Notice to Lessee, deliver notice to Lessor of Lessee's intention to exercise its First-Offer Right with respect to all the Specific First-Offer Space. If Lessee desires to elect to exercise its First-Offer Right only with respect to a portion of that space, Lessor may reject Lessee's exercise if Lessor determines, in Lessor's reasonable discretion, that the remaining portion of the space cannot be reasonably marketed to third parties, due to size, configuration or other factors.

64.5 Effect of Lessee's Failure to Exercise First-Offer Right. If Lessee does not exercise its First-Offer Right within the response period specified in subparagraph 64.4, the First- Offer Right shall terminate for the Specific First-Offer Space and Lessor shall be free to lease the Specific First-Offer Space, or any portion thereof, to anyone on any terms at any time within six (6) months after the delivery of the First-Offer Notice, without any obligation to provide Lessee with a further right to lease that space.

64.6 Restrictions on First-Offer Right. The First-Offer Right shall be personal to the originally named Lessee and shall be exercisable only by the originally named Lessee (and not any assignee, sublessee, or other transferee of Lessee's interest in this Lease, except an Affiliate). The originally named Lessee (and any Affiliate) may exercise the First-Offer Right only if that Lessee occupies the entire Premises as of the date of the First-Offer Notice. Lessee shall not have the right to lease First-Offer Space if Lessee is in Default under this Lease as of the date of the attempted exercise of the First-Offer Right by Lessee or (as Lessor's option) as of the scheduled date of delivery of the Specific First-Offer Space to Lessee.

64.7 Delivery of First-Offer Space. If Lessee timely and validly exercised the First- Offer Right, Lessor shall deliver the Specific First-Offer Space to Lessee on the date as reasonably determined by Lessor ("**Delivery Date**") on which the Specific First-Offer Space is available for occupancy. Lessor shall not be liable to Lessee or otherwise be in default under this Lease if Lessor is unable to deliver the Specific First-Offer Space to Lessee on the projected Delivery Date due to the failure of any other lessee to timely vacate and surrender to Lessor the Specific First- Offer Space or any portion of it.

64.8 Terms and Conditions Applicable to First-Offer Space. If Lessee timely and validly exercises the First-Offer Right, then beginning on the Delivery Date and continuing for the balance of the Original Term (including extensions):

(a) The Specific First-Offer Space shall be part of the Premises under this Lease (so that the term"**Premises**" in this Lease shall refer to the space in the Premises immediately before the Delivery Date plus the Specific First-Offer Space);

(b) Operating Expenses shall be adjusted to reflect the increased rentable area of the Premises; and,

(c) The Security Deposit shall increase by an amount equal to the first full month's Base Rent and Operating Expenses for the Specific First-Offer Space and Lessee shall pay such increased amount by not later than the Delivery Date.

Lessee's lease of the Specific First-Offer Space shall be on the same terms and conditions as affect the original Premises from time to time, except as otherwise provided in this Section 65. Rent and all other economic terms applicable to the Specific First-Offer Space shall be equal to the Fair Market Rental Rate of the space, as defined and determined pursuant to Paragraph 71 below, with annual cost of living adjustments determined in accordance with Paragraph 52.A.II.b of this Lease. Lessee's obligation to pay Rent

with respect to the Specific First-Offer Space shall begin on the Delivery Date. The Specific First-Offer Space shall be leased to Lessee in its"as-is" condition.

Lessor shall not be required to construct any improvements in, or contribute any improvement allowance for, the Specific First-Offer Space (provided that an improvement allowance may be factored into the determination of the Fair Market Rental Rate of the Specific First-Offer Space, if appropriate).

64.9 Confirmation of Terms. If Lessee timely and validly exercises the First-Offer Right, Lessor and Lessee shall, within fourteen (14) days after the initial Base Rent has been determined, execute an amendment to this Lease confirming the addition of the Specific First- Offer Space to the Premises on the terms and conditions set forth in this Paragraph 65.

(a) The actual Delivery Date;

(b) The rentable area of the Premises with the addition of the Specific First-Offer Space;

(c) The initial Base Rent; and,

(d) Any other term that either party reasonably requests be confirmed with respect to the Specific First-Offer Space.

66. Right of First Negotiation. If Lessee has not exercised a First-Offer Right with respect to a Specific First-Offer Space in accordance with paragraph 65 of this Lease and Lessor thereafter receives an offer from a third party that incorporates all of the basic terms of a proposed transaction to lease such space **("Lease Offer")** and Lessor is willing to accept the Lease Offer, then Lessor shall submit written notice of the Lease Offer to Lessee. Lessee will have five (5) business days following Lessor's delivery of the Lease Offer (or ten (10) business days in the event that Lessor unintentionally failed to provide Lessee with a First-Offer Notice for such space) to exercise Lessee's right to enter into a lease for the Specific First-Offer Space on the terms and conditions set forth in this paragraph 66 by delivering a written notice **("Lessee Acceptance Notice")** to Lessor of such exercise and Lessee's commitment to lease the Specific First-Offer Space. If Lessee fails to deliver the Lessee Acceptance Notice to Lessor within this five (5) business day period (or ten (10) business day period, as the case may be), Lessee will be deemed to have waived Lessee's right to lease the Specific First-Offer Space. If Lessee timely and validly delivers the Lessee Acceptance Notice as provided herein, then the terms and conditions applicable to the lease of the Specific First-Offer Space shall be as set forth in subparagraph 64.8 above and Lessor and Lessee shall execute an amendment to the Lease within fourteen (14) days after the initial Base Rent has been determined as provided is subparagraph 64.9 above. Lessee shall only have rights pursuant to this paragraph 66 as to New Construction if at least sixty (60) months remain on the term of this Lease, except that Lessee may exercise any remaining Option to Extend (as set forth at paragraph 52 of this Lease) early if necessary to satisfy this requirement. Lessee shall only have rights pursuant to this paragraph 66 as to Previously Leased Space if at least thirty-six (36) months remain on the term of this Lease, except that Lessee may exercise any remaining Option to Extend (as set forth at paragraph 52 of this Lease) early if necessary to satisfy this requirement.

67. Right of First Offer to Purchase.

(a) Subject to the provisions of this paragraph 67, during the lease term and any extensions thereof (the**"First Offer Period")**, Lessee shall have a right of First Offer to purchase the Premises (but not including any expansion areas leased by Lessee pursuant to paragraphs 65 or 66 of this Lease). Lessee's right of First Offer shall be deemed to be an "Option" as defined in paragraph 39 of this Lease and subject to all of the provisions and limitations set forth in such paragraph.

(b) If, at any time during the First Offer Period, Lessor decides, in its sole and absolute discretion, that it is interested in selling the Premises Lessor shall notify Lessee in writing of such interest (the **"First Offer Notice")** and the price at which Lessor is willing to sell the Premises (the**"Offer Price")**. Lessor is not, however, under any obligation to sell the Premises.

(c) If Lessor should send a First Offer Notice to Lessee and Lessee wishes to exercise Lessee's right of First Offer with respect to the Premises, then within ten (10) days of delivery of the First Offer Notice to Lessee, Lessee shall deliver notice to Lessor of Lessee's exercise of its right of First Offer (**"Acceptance Notice"**).

(d) If Lessee does not deliver to Lessor its Acceptance Notice with respect to the Premises within the specified delivery period, time being of the essence, then Lessee's right of First Offer shall terminate.

(e) If Lessee delivers the Acceptance Notice in a timely fashion then Lessor and Lessee shall have thirty (30) days from the delivery of the First Offer Notice to enter into a binding purchase and sale agreement (**"Purchase Agreement"**) with a closing date no

later than forty-five (45) days from the execution of the Purchase Agreement, but without any obligation to enter into a Purchase Agreement. If Lessor and Lessee do not enter into a Purchase Agreement, Lessor may offer the Premises to any third party for sale. However, if Lessor fails to sell the Premises for a price that is at least as high as two (2%) less than the Offer Price and subsequently desires to offer the Premises for sale at a price that is at or below two (2%) less than the Offer Price, Lessor must first present another First Notice Offer to Lessee.

(f) In addition to the provisions of paragraph 39 of this Lease, if this Lease or Lessee's right to possession of all or any portion of the Premises shall terminate in any manner whatsoever, then immediately upon such termination the Right of First Offer herein granted shall simultaneously terminate and become null and void and of no force or effect whatsoever. Time is of the essence with regard to Lessee's Right of First Offer.

(g) Lessee's right of First Offer is intended to apply only to voluntary transfers involving third party transferees and shall not apply therefore: where the Premises or any portion of either is taken by eminent domain or sold under threat of condemnation, to transfers to an entity related to the Lessor, to intra-family or intra-ownership transfers, or to transfers by Lessor to a trust created by Lessor or if Lessor is a trust to transfers to a trust beneficiary.

(h) In the event that Lessee purchases the Premises in the manner provided in this paragraph 67, Lessor shall pay to Lessee's Broker a commission equal to one and one-half (1.5%) of the purchase price, less any unamortized leasing commission paid to Lessee's Broker.

68. Payment to Brokers. Lessor shall pay to the Lessee's Brokerage Firm for the brokerage services rendered by the Lessee's Brokers in connection with the Lease an amount equal to three percent (3%) of total Base Rent payable for the first sixty (60) months of the Original Term (net of the abatements pursuant to paragraph 53 of this Lease) and one and one-half percent (1.5%) of the total Base Rent for months sixty-one (61) through one hundred twenty (120) of the Original Term (**"Lessee's Broker Commission"**). Such Lessee's Broker Commission shall be divided between the Lessee's Agents pursuant to the terms of a separate agreement between Lessee's Agents. Such Lessee's Broker Commission shall be paid fifty percent (50%) upon full execution of this Lease and fifty percent (50%) on the Commencement Date.

69. Security Deposit. In the event that Lessee exercises an option to extend the term of the Lease as set forth in Paragraph 52 of the Lease, the amount of the Security Deposit, effective on the commencement of such option period, shall be adjusted to the amount that is the sum of (i) the monthly Base Rent payable at the commencement of the option period, and (ii) the Operating Expenses payable monthly at the commencement of the option period. Lessee shall deposit with Lessor any amount necessary to modify the Security Deposit in accordance with this Paragraph 69 by not later than the commencement of the option period.

70. Lessee Access. Lessee shall have access to the Building and use of the parking spaces situated at the Premises seven days a week, 24 hours per day, subject to any reasonable Rules and Regulations established by Lessor. Lessee shall have control over the hours of operation of the HVAC serving the Premises.

71. Fair Market Rental Value. With respect to the Right of First Offer and Right of First Negotiation provisions in Sections 65 and 66 above, the applicable Fair Market Rental Rate shall be the effective rate that Lessee has accepted in current transactions at the Project (or if there are not a sufficient number of such transactions, then that which comparable landlords of comparable buildings have accepted in current transactions) from new (non-expansion and non-renewal transactions) and nonaffiliated tenants for comparable use, comparable tenant improvements and for comparable term, with the determination of Fair Market Rental Rate to take into account all relevant factors, including the following:

a. use, location, size;

b. location, quality, age and extent of leasehold improvements (or to be provided);

c. abatements (including with respect to Base Rental, Operating Expenses and Property Taxes);

d. tenant improvement, refurbishment and repainting allowances;

e. the payment of a leasing commission(s);

f. any other relevant term or condition in making an "effective fair market value" rental rate determination.

If Lessee and Lessor are unable to agree upon the effective Fair Market Rental Rate for any particular space within thirty (30) days, then the final determination shall be subject to arbitration as described in Paragraph 52.a.(1) of this Lease. As part of such arbitration process, Lessor shall disclose to Lessee (and, if applicable the arbitrator) all relevant information concerning comparable transactions in the Project subject only to any confidentiality agreements that were required by the tenants (as opposed to those required by the Lessor) and were subject to a written confidentiality agreement prior to Lessee's Option Exercise Notice. Lessee and, if applicable, Lessee's arbitrator will agree to execute Landlord's commercially reasonable confidentiality agreement

[Signatures are on next page.]

IN WITNESS THEREOF, Lessor and Lessee have executed this Addendum concurrently with the Lease of even date herewith.

LESSOR:

RAF PACIFICA GROUP - REAL ESTATE FUND IV, LLC,
a California limited liability company

By: /s/ Steven C. Leonard
Steven C. Leonard, Manager

APG HOLLYWOOD CENTER, LLC,
a California limited liability company

By: K Associates,
a California general partnership
Its: sole and Managing Member

By: /s/ Michael B. Kaplan
Name: Michael B. Kaplan
Its: Managing General Partner

APG AIRPORT FREEWAY CENTER, LLC,
a California limited liability company

By: K Associates,
a California general partnership
Its: sole and Managing Member

By: /s/ Michael B. Kaplan
Name: Michael B. Kaplan
Its: Managing General Partner

LESSEE:

INOGEN, INC.,
a Delaware corporation

By: /s/ Scott Wilkinson
Scott Wilkinson, President

By: /s/ Alison Bauerlein
Alison Bauerlein, Secretary

EXHIBIT A

Site Plan Depicting Premises and Project

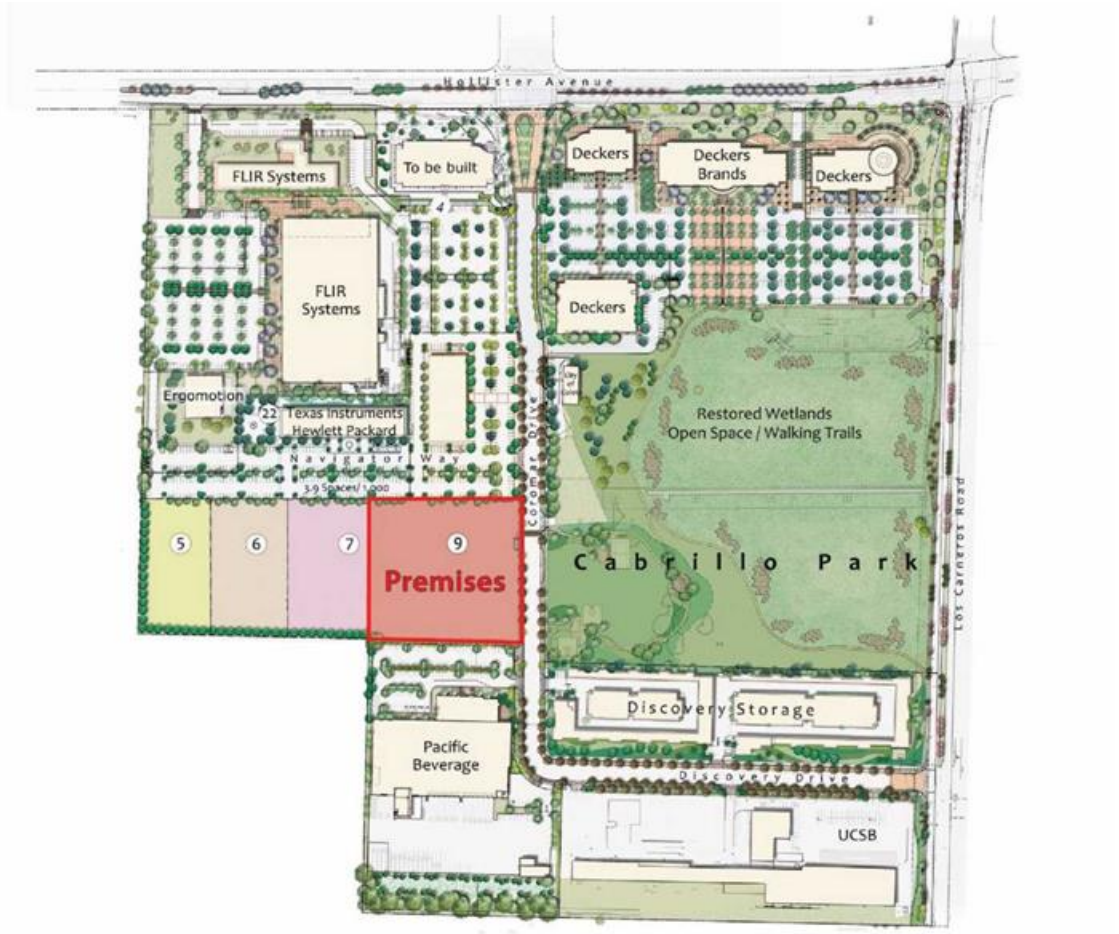
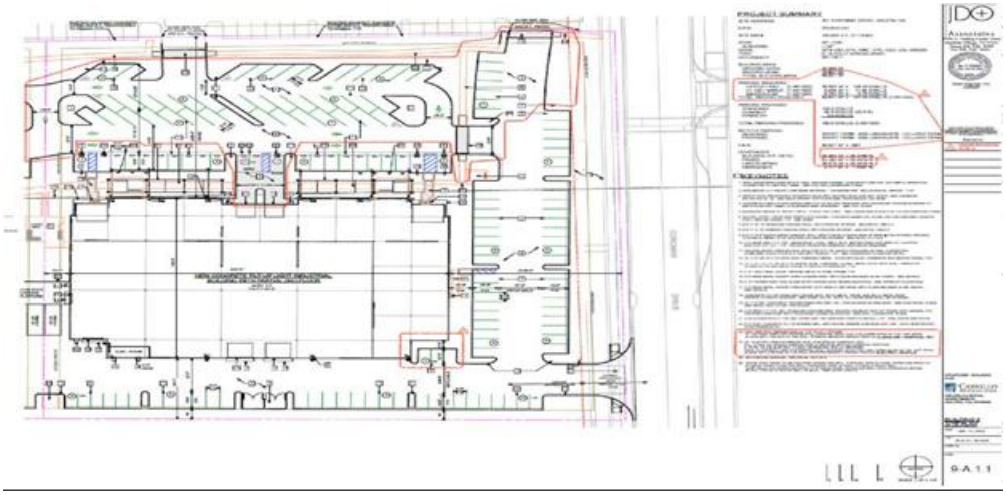


EXHIBIT A-1

Plans for Base Building Improvements



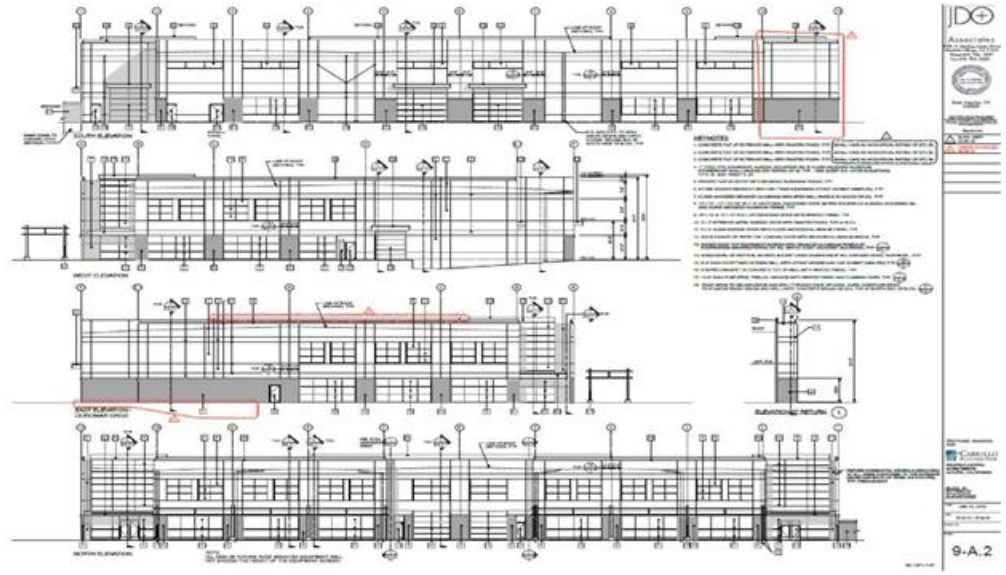


EXHIBIT B

WORK LETTER

This Work Letter shall set forth the terms and conditions relating to the construction of the Lessee Improvements in the Premises. This Work Letter is essentially organized chronologically and addresses the issues of the construction of the Premises, in sequence, as such issues will arise during the actual construction of the Premises. All references in this Work Letter to Articles or Sections of "this Lease" shall mean the relevant portion of the Standard Industrial/Commercial Multi-Tenant Lease − Net to which this Work Letter is attached as Exhibit B and of which this Work Letter forms a part, and all references in this Work Letter to Sections of "this Work Letter" shall mean the relevant portion of Sections 1 through 4 of this Work Letter.

SECTION 1
CONSTRUCTION DRAWINGS FOR THE PREMISES

Lessor shall construct "turnkey" lessee improvements in the Premises (the **"Lessee Improvements"**) pursuant to the space plan attached hereto as Exhibit B-1 (**"Space Plan"**) and any construction drawings based thereon (collectively, the **"Plans"**), utilizing Lessor's specifications for the standard components to be used in the construction of the Lessee Improvements in the Premises (collectively, the "**Standard Improvement Package**") a copy of which is attached hereto as **Exhibit B-2**. Lessee shall make no changes or modifications to the Plans or the Lessee Improvements without the prior written consent of Lessor, which consent may be withheld at Lessor's option if such change or modification would, in Lessor's sole and absolute discretion:

1.1 directly or indirectly delay the "Substantial Completion" of the Lessee Improvements as that term is defined in Section 2.1 of this Work Letter,

1.2 materially increase the cost of designing or constructing the Lessee Improvements and/or Base Building Improvements (unless Lessee agrees to pay for such additional cost),

1.3 require modification to any portion of the Building other than the Premises,

1.4 detrimentally affect any of the Building utilities, systems, or structure, or the value, use, or appearance of the Project,

1.5 interfere with the operations of any tenants of the Project,

1.6 increase the cost of operating the Project, or

1.7 violate any Applicable Requirement affecting the Building, the Project or otherwise binds Lessor.

A request by Lessee to change the Plans (herein, a **"Change Order"**) shall be in writing, with sufficient details to prepare a Change Order Estimate (as defined below) and delivered to Lessor's Representative. Unless Lessor objects for a reason set forth above (except for a reason based upon increase in the cost of designing or constructing the Lessee Improvements and/or Base Building Improvements) or the Change Order lacks sufficient details for Lessor to prepare the Change Order Estimate, Lessor shall cause Lessor's contractor (**"Contractor"**) to prepare an estimated of the increased cost and/or time attributable to the Change Order (the **"Change Order Estimate"**) and deliver such to Lessee. Lessee shall elect whether or not to approve the Change Order Estimate within three (3) business days after receipt of such; and any failure to timely approve or reject the Change Order Estimate shall be deemed a rejection of the Change Order Estimate. Any delay in constructing the Lessee Improvements or Base Building Improvements arising out of a Change Order shall constitute Lessee Delay. Any reasonable cost incurred by Lessor in considering and/or implementing a Change Order (including, without limitation, additional design and engineering costs attributable to the preparation of the Change Order Estimate) shall be included in the Change Order Estimate and shall be payable by Lessee before implementation of the Change Order.

SECTION 2
COMPLETION OF THE LESSEE IMPROVEMENTS; COMMENCEMENT DATE

2.1 **Substantial Completion.** For purposes of the Lease, "Substantial Completion" of the Premises shall occur upon the completion of construction of the Lessee Improvements in the Premises pursuant to the Plans, as determined by the Lessor's architect, and all approvals required by the City of Goleta for occupancy of the Premises have been issued, notwithstanding the fact that minor details of construction, mechanical adjustments or decorations which do not materially interfere with Lessee's use of the Premises remain to be performed (items normally referred to as "Punch List Items"), and any tenant fixtures, telephones and computers and any cabling related thereto, photocopy machines, and work-stations, built-in furniture, or equipment have not yet been installed, the purchase and installation of which shall be Lessee's sole responsibility.

2.2 **Delay of the Substantial Completion of the Premises.** Except as provided in this Section 2.2, the Commencement Date shall occur as set forth in Paragraph 3 and 54 of this Lease. If there shall be a delay or there are delays in the Substantial Completion of the Premises or in the occurrence of any of the other conditions precedent to the Commencement Date, as set forth in Paragraph 3 of this Lease, as a direct, indirect, partial, or total result of:

2.2.1 Lessee's failure to timely approve any matter requiring Lessee's approval;

2.2.2 A Breach by Lessee of the terms of this Work Letter or this Lease;

2.2.3 Changes in the Plans or the Lessee Improvements made at the request of Lessee;

2.2.4 Changes to the Base Building Improvements due to changes made at the request of Lessee; or

2.2.5 Any other acts or omissions of Lessee, or its agents, or employees that actually delay the completion of the Lessee Improvements or Base Building Improvements;

(each of the foregoing a "Lessee Delay") then, notwithstanding anything to the contrary set forth in this Lease or this Work Letter and regardless of the actual date of the Substantial Completion of the Premises, the Commencement Date shall be deemed to be the date the Commencement Date would have occurred if no Lessee Delay or delays, as set forth above, had occurred. Notwithstanding anything to the contrary contained herein, except for a delay arising out of a Change Order, no Lessee Delay shall be deemed to have occurred until Lessor notifies Lessee's Representative in writing of any event or circumstance constituting such Lessee Delay and Lessee fails to cure such Lessee Delay within 24 hours after receipt of such written notice.

2.3 **Contractor's Warranty.** The Lessor's construction contract for the Lessee Improvements shall contain a warranty from the Lessor's contractor in format substantially similar to Section 3.5 of the General Conditions of the Contract for Construction, 2007 edition of AIA Document A201 (**"Contractor's Warranty"**) with respect to the Lessee Improvements, and shall provide for customary warranties and guaranties to be obtained by Lessor's contractor from the manufacturers of any equipment installed as part of the Lessee Improvements. Lessor shall assign all manufacturers' equipment warranties relating to the Lessee Improvements, to the extent assignable, upon the expiration of the Lessor's warranties set forth in Paragraph 2 of the Lease.

SECTION 3
PUNCH LIST PROCEDURE

Within fifteen (15) days after Lessor notifies Lessee that Substantial Completion of the Lessee Improvements is scheduled to occur, Lessor and Lessee (along with Lessor's architect and Lessor's contractor) shall conduct an inspection of the Premises (the **"Joint Inspection"**) and thereafter mutually develop a **"Punchlist"**, identifying the corrective work of the type commonly found on a list of "Punch List Items", which list shall be based on whether such items were required as part of the Base Building Improvements and Lessee Improvements (as may have been modified pursuant to this Work Letter), as reasonably determined by Lessor's architect. Lessor shall instruct Lessor's contractor to commence and diligently perform the work of correction of all Punchlist items to completion, but the completion of such corrective work shall not affect the Substantial Completion. Without affecting Lessee's rights with respect to the Contractor's Warranty, any deficiencies in the Lessee Improvements not described in the Punchlist or within the Lessor's warranty period set forth at Paragraph 2 of the Lease shall be deemed waived. Punch List Items shall not include any damage caused in connection with Lessee's move-in or early access to the Premises pursuant to Section 4.1.

SECTION 4
MISCELLANEOUS

4.1 **Lessee's Entry Into the Premises Prior to Substantial Completion.** Provided that Lessee and its agents do not interfere with Contractor's work in the Building and the Premises, Contractor shall allow Lessee access to the Premises beginning on the date that is thirty (30) days before Substantial Completion as estimated by Lessor's architect, for the purpose of Lessee installing Lessee's equipment, fixtures and furnishings (including Lessee's data and telephone equipment) in the Premises. Prior to Lessee's entry into the Premises as permitted by the terms of this Section 4.1, Lessee shall submit a schedule to Lessor and Contractor, for their approval, which schedule shall detail the timing and purpose of Lessee's entry. Any entry into the Premises by Lessee, or any storage or installation of any property in the Premises by Lessee prior to Substantial Completion of the Lessee Improvements (if approved in writing in advance by Lessor) shall be at the sole risk of Lessee, including, but not limited to theft, bodily injury, vandalism or other damage. Lessee shall strictly comply with all requirements of Lessor and Lessor's contractor concerning Lessee's entry into the Premises before Substantial Completion of the Lessee Improvements. Lessee shall hold Lessor harmless from and indemnify, protect and defend Lessor against any loss or damage to the Building or Premises and against injury to any persons caused by Lessee's actions pursuant to this Section 4.1.

4.2 **Lessee's Representative.** Concurrently with Lessee's execution and delivery of this Lease, Lessee shall designate its sole representative with respect to the matters set forth in this Work Letter, who, until further written notice to Lessor, shall have full authority and responsibility to act on behalf of the Lessee as required in this Work Letter. Upon request from Lessor or its representative, architect, contractor or engineer, Lessee's representative shall supply such information, and issue such approvals as may be requested, to complete the design and construction of the Lessee Improvements.

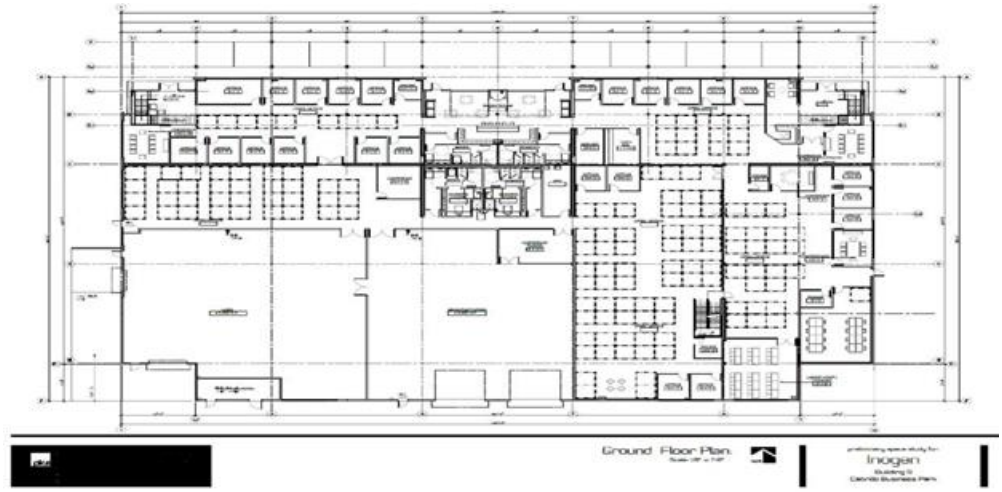
4.3 **Lessor's Representative.** Following the mutual execution and delivery of this Lease, Lessor shall designate its sole representatives with respect to the matters set forth in this Work Letter, who, until further notice to Lessee, shall have full authority and responsibility to act on behalf of the Lessor as required in this Work Letter.

4.4 **Time of the Essence in This Work Letter.** Unless otherwise indicated, all references herein to a "number of days" shall mean and refer to calendar days. In all instances where Lessee is required to approve or deliver an item, if no written notice of approval is given or the item is not delivered within the stated time period, at Lessor's sole option, at the end of such period the item shall automatically be deemed approved or delivered by Lessee and the next succeeding time period shall commence.

4.5 **Lessee's Lease Default.** Notwithstanding any provision to the contrary contained in this Lease, if an event of Default as described inParagraph 13.1 of this Lease, or a default by Lessee under this Work Letter, has occurred at any time on or before the Substantial Completion of the Premises, then (i) in addition to all other rights and remedies granted to Lessor pursuant to this Lease, Lessor shall have the right to cause Contractor to cease the construction of the Premises (in which case, Lessee shall be responsible for any delay in the Substantial Completion of the Lessee Improvements caused by such work stoppage as set forth in Section 4 of this Work Letter), and (ii) all other obligations of Lessor under the terms of this Work Letter shall be forgiven until such time as such default is cured pursuant to the terms of this Lease

EXHIBIT B-1

Space Plan for Lessee Improvements



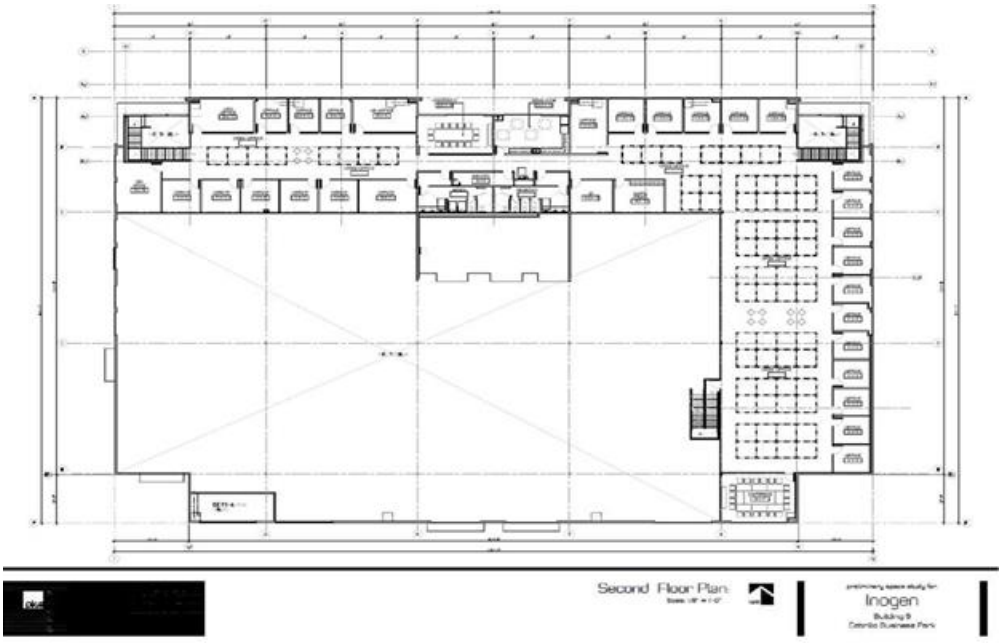


EXHIBIT B-2

Standard Improvement Package

INOGEN
TENANT IMPROVEMENT SPECIFICATIONS
BUILDING 9 − CABRILLO BUSINESS PARK
2 APRIL 2019

Below are the Tenant Improvement Specifications for the build-out of Inogen's new facility in Building 9 at Cabrillo Business Park. All drawings and specifications shall be prepared by a registered architect and/or professional engineer prior to submittal to City.

1. TENANT IMPROVEMENT

1.1 Interior Partition (@ Suspended Ceilings).

1.1.1 Minimum 3 5/8" x 25-gauge metal studs @ 24" on center with seismic bracing unless noted otherwise (U.N.O.).

1.1.2 5/8" type "X" gyp. board, one layer on each side of studs.

1.1.3 Height from floor slab to underside of ceiling grid.

1.1.4 Partition taped smooth to receive eggshell paint finish.

1.1.5 "L" metal at termination of partition to ceiling.

1.1.6 Sound sealed gasket closure (black neoprene) at mullion termination or glass curtain wall.

1.1.7 Horizontal bracing per code.

1.1.8 Corner bead to termination or partition to ceiling.

1.1.9 All walls to receive 5/8" type "X" gyp. board.

1.1.10 All columns within office areas will be furred to 6" above ceiling line.

1.2 Sound Attenuation Partition

1.2.1 3 5/8" x 20-gauge metal studs @ 24" on center with seismic bracing, U.N.O.

1.2.2 5/8" type "X" gyp. board, one layer on each side of studs.

1.2.3 Height from floor slab to underside of structure above.

1.2.4 Partition taped smooth to receive eggshell paint finish.

1.2.5 Sound attenuation fiberglass batt insulation in each stud bay.

1.2.6 "L" metal at termination of partition to ceiling.

1.2.7 Straight line termination at building columns. Sound sealed gasket closure (black neoprene) at mullion termination.

1.2.8 Stagger and caulk around electrical outlets and other boxes. Caulk around conduit and other through-the-wall penetrations. Caulk entire perimeter of wall at floor, exterior wall and ceiling, and between "L" metal finished drywall and intersected surface.

1.2.9 Framing as required for fire damper ducts, where occurs.

1.2.10 Break metal cap with neoprene gasket at exterior glazing.

1.2.11 Air transfer grilles per code.

1.2.12 Sound seals at top and bottom of partition.

1.2.13 Sound boots at all mechanical penetrations.

1.3 **Interior Partition (@ 2-Story Areas)**

1.3.1 Minimum 6” x 20-gauge metal studs @ 16” on center with seismic bracing, U.N.O.

1.3.2 5/8” type “X” gyp. board, one layer on each side of studs.

1.3.3 Height from floor slab to underside of roof structure above.

1.3.4 Partition taped smooth to receive eggshell paint finish.

1.3.5 “L” metal at termination of partition to ceiling.

1.3.6 Horizontal bracing per code.

1.3.7 Air transfer grilles per code.

1.4 **Window Furring**

1.4.1 Sill, Head & Jambs: Buildings exterior metal stud wall framing to receive 5/8” type “X” gyp. board.

1.4.2 Corner bead at all outside corners.

1.4.3 R-8 rigid insulation.

1.5 **Exterior Wall Furring**

1.5.1 All exterior walls to receive 2 1/2” x 25-gauge metal studs @ 24” on center, U.N.O.

1.5.2 5/8” type “X” gyp. board to 6” above ceiling line.

1.5.3 R-8 rigid insulation.

1.6 **Interior Door Assembly.**

1.6.1 Office − 3’-0” x 9’-0” x 1-3/4” solid core doors (plastic laminate finish, color TBD).

1.6.2 Latchset − Schlage ‘ND’ Series, dull chrome finish 626, cylindrical with matching strike 40” A.F.F. to centerline lever. Lever: Schlage ‘Sparta’ Finish: 626 Chromium Plated (Or approved equal)

1.6.3 Lockset − Schlage ‘ND’ Series with lock. Dull chrome finish 626, cylindrical with matching strike 40” A.F.F. to centerline lever. Lever: Schlage ‘Sparta’ Finish: 626 Chromium Plated (Or approved equal)

1.6.4 Hinges − 4-1/2” x 4-1/2” Stanley − CB 19020 5 knuckle butt hinges, 2 pair finish to match door frame. Ball bearing hinges at all doors with closers. (Or approved equal)

1.6.5 Door Stop − Builders Brass Works #1210 dome floor stop. Dull chrome finish, 626. (Or approved equal)

1.6.6 Frame − 3’-0” x 8’-0”, Western Integrated aluminum. Color- Clear anodized aluminum. (Or approved equal)

1.6.7 Glass Sidelight – 1/4” tempered cleat glass in a 3’-0” x9’-0”, Western Integrated aluminum frame. Color- Clear anodized aluminum.

1.7 **Suspended Ceiling**

1.7.1 Office Areas − Standard 2’ x 2’ suspended “Armstrong Silhouette XL 9/16” Bolt Slot grid with 1/4” Reveal grid, color: white with 2’ x 2’ Armstrong Dune Tegular ceiling tile or equivalent. Ceiling height to be 9’x 0” A.F.F. (Or approved equal)

1.7.2 Wire suspension per code. Seismic and compression posts to meet current code

1.8 **Lighting.**

1.8.1 **2’ X 4’ LED Dimmable Light Fixture**

1.8.1.1 2’ x 4’ LED dimmable light fixture. Lithonia Lighting, Volumetric Troffer (VT), 2VTL4-48L-ADP-EZ1-LP835-N80 (Or approved equal)

1.8.1.2 Wire: Suspension per code.

1.8.1.3 Connect one fixture per 1,500 square feet to be emergency 24-hour lighting.

1.8.1.4 One Fixture for each 80 square feet of floor area.

1.8.2 **Light Controls**

1.8.2.1 Wall Mount at 40” A.F.F. to center of switch.

1.8.2.2 Wall Mounted Single Load: Wallstopper, PW-101D LED Compatible Line Voltage Combination PIR Occupancy Sensor and Dimmer Switch (Or approved equal)

1.8.2.3 Single- and Multi-Level Low Voltage Switching Room Controller: Wallstopper LMRC-211 (Single-level), -212 (Bi-level), or -213 (3-level) Switching with 0-10V Dimming (Or approved equal)

1.8.2.4 Occupancy Sensor: Wattstopper LMDC-100 Ceiling Mounted Low Voltage Dual Technology

1.8.2.5 Daylight Control: Wallstopper LMLS-400 (Single-zone) or -500 (Multi-zone) Ceiling Mounted Low Voltage Photosensor with 0-10V Dimming (Or approved equal)

1.8.2.6 Low Voltage Room Control Stations: Wallstopper LMDM-101 thru 108 Multi-Button Dimming and/or LMSW-105 5-button Scene Select with Dimming (Or approved equal)

1.8.2.7 Occupancy Sensor for Open Ceiling Areas: Finelite −OBO Furnished With Each Fixture (Or approved equal)

1.8.3 **Exit Signs**

1.8.3.1 Edge-lit LED Exit Sign, Signtex Inc. Lighting, Crystal Recessed Series CRR, Green letters with directional arrows as required. (Or approved equal)

1.8.4 **Linear LED Pendant Light Fixture (Open Ceiling Areas)**

1.8.4.1 High performance 2” aperture Indirect/Direct linear LED pendant fixture, Finelite Inc., HP-2 ID, CRI/CCT − 835 80 CRI min. 3500K, Uplight Output − S Standard, Downlight Output − S Standard (Or approved equal)

1.8.4.2 Cable Mount at height TBD

1.8.5 **4” LED Recessed Downlight**

1.8.5.1 Lum-Tech Lighting, LEDH-CFK4, CCT − 3500K with LEDT_R44 Specular Open Reflector

1.9 **Electrical Wall Outlets**

1.9.1 General Use: Leviton Decora, or equal, duplex receptacle #16252-W 15A rated, self-grounding, white finish.

1.9.2 Dedicated Circuit: Leviton Decora, or equal, duplex receptacle #16352-W 20A rated, self-grounding, white finish.

1.9.3 No more than eight general use outlets per single 120 volts circuit.

1.9.4 Mounted vertically at 18” A.F.F. to centerline of outlet.

1.10 **Data/Communications Outlets**

1.10.1 Backbox, Switchring, and Pullstring.

1.10.2 3/4” metal conduit in wall cavity stubbed to above ceiling with protective plastic bushing.

1.10.3 White wallplate to match Decora style receptacles. Wallplate and all wiring at Tenant’s cost and by Tenant’s vendor.

1.11 **Heating and Air Conditioning**

1.11.1 Provide rooftop package gas/electric heating and cooling units for all office, manufacturing, lab, and warehouse spaces. Provide supply and return HVAC ducting to all areas.

Note:

- Rooftop units must meet a height restriction to maintain a maximum 35 foot elevation above grade due to airport flight path.
- Minimum efficiencies of 11.0 EER or 14.0 SEER.

1.11.2 Provide split system ductless cooling only units for small computer rooms.

1.11.3 Provide (1) zone per 1,500 square feet (average). Note: Interior open plan areas can be larger zones.

Note:

- Furnish and install low-pressure distribution supply and return air sheet metal ductwork.
- Furnish and install supply and return air registers, flush mounted with perforated face in T-bar ceiling. Furnish and install louvered face supply and return air registers in exposed structure ceiling areas.
- Balance system by independent agency in accordance with engineered plans and submit balance report upon completion of improvements. (Subject to approval by owner).
- All thermostats to be programmable.

1.12 **Plumbing**

1.12.1 Provide vitreous china wall hung water closets, urinals, lavatories.

Note:

- All low flow sensor activated fixture flush valves and faucets.
- Must meet California Green Code flow rates.

1.12.2 Provide on demand water heating sources (i.e. gas tankless or electric insta-hot water heaters).

1.13 **Fire Protection**

1.13.1 Sprinkler heads to be semi-recessed chrome. Center in ceiling tile.

1.13.2 Fire Extinguishers type and location by local Fire Marshall.

1.14 **Floor Covering Requirements**

1.14.1 Modular Carpet Tile: J & J Invision, Style: Inception Accent 7018 or Inception Neutral 7019, 18” x 36” Plank, color and installation method to be determined. (Or approved equal)

1.14.2 Vinyl Composition Tile: Mannington. 12 x 12 gauge “Progressions” or equivalent. Color: to be selected. (Or approved equal)

1.14.3 Luxury Vinyl Tile: Shaw Contract, Collection: Terrain II, Style Terrain II 20 Mil. Color and installation method to be determined. (Or approved equal)

1.15 **Rubber Base**

1.15.1 Base (throughout): Johnsonite 2-1/2” rubber cove base. Color: to be selected. (Or approved equal)

1.16 **Wall Finish**

1.16.1 Dunn Edwards or equal. Color: to be selected.

1.16.2 One coat of primer and two coats semi-gloss interior latex paint to cover walls with one accent colors as required.

1.17 **Window Coverings**

1.17.1 Manually Operated Roller Shades: Mecho Shade Systems, Mecho/5 Manual Shade System, Openness − 1%, color to be determined. (Or approved equal)

Note: Building owner reserves the right to modify these finishes prior to construction of the tenant improvements

EXHIBIT C

Declaration of CC&R's

2016-0015804

RECORDING REQUESTED BY	Recorded	REC FEE	24.00
CHICAGO TITLE	Official Records		
	County of	CONFORMED COPY	2.00
	Santa Barbara		
RECORDING REQUESTED BY	Joseph E. Holland		
AND WHEN RECORDED MAIL TO:	County Clerk Recorder		
		XR	
	08:00AM 05-Apr-2016	Page 1 of 4	

Santa Barbara Realty Holding Company, L.L.C.
c/o SARES Regis Group
996 S. Seaward Avenue
Ventura, CA 93001
Attention: Mr. Russ Goodman

(Space Above For Recorder's Use)

FIFTH AMENDMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK

THIS FIFTH AMENDMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK ("**Fifth Amendment**") is made as of March 24, 2016, by SANTA BARBARA REALTY DEVELOPMENT, L.L.C., a Delaware limited liability company ("**SBRD**") with reference to the following:

RECITALS:

A. On April 27, 2009, that certain Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park was recorded in the Official Records of Santa Barbara County, California ("**Official Records**") as Instrument No. 2009-0023212 (the "**Original Declaration**"), as amended by that certain First Amendment to Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park (the "**First Amendment**") recorded in the Official Records on December 1, 2011 as Instrument No. 2011-0069878.

B. Pursuant to the First Amendment, SBRD assumed all of the rights and obligations of Santa Barbara Realty Holding Company, LLC and became the"Declarant" under the Original Declaration. SBRD thereafter caused (i) that certain Second Amendment to Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park (the "**Second Amendment**") recorded in the Official Records on December 13, 2013 as Instrument No. 2013-0077957; (ii) that certain Third Amendment to Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park (the "**Third Amendment**") recorded in the Official Records on April 15, 2014 as Instrument No. 2014-0016611; and (iii) that certain Fourth Amendment to Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park (the "**Fourth Amendment**") recorded on April 15, 2015 in the Official Records as Instrument No., 2014-0016612. The Original Declaration, as amended by the First Amendment, the Second Amendment, the Third Amendment and the Fourth Amendment, shall be referred to herein collectively as the "**Declaration**". The Declaration encumbers the Project.

C. Capitalized terms used but not defined herein shall have the meanings given such terms in the Declaration.

D. Article 14 of the Declaration allows for the amendment of the Declaration by a written instrument duly recorded in the Official Records after being duly signed and acknowledged by those Owners holding at least seventy-five percent (75%) of the Members' voting power.

E. As of the date hereof, Declarant holds at least seventy-five percent (75%) of the Members' voting power

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Declaration is amended as follows.

1. Common Parking Expenses. Section 2.4(c) of the Declaration is hereby amended by adding the following sentence to the end of the paragraph:

"For the purpose of determining which Building Lot Owners are entitled to use the Common Parking Areas in question and share in the Common Parking Area Expenses related thereto, it is intended that Occupants and Permittees of each Building will utilize and share in Common Area Expenses related thereto only for the Common Parking Areas most proximate to their Building, consistent with the non-exclusive parking easements contemplated in Section 12.6(a) below for easements over the Common Parking Areas most proximate to the Building owned or occupied by such Owner and the Occupants and Permittees of such Building, as reasonably necessary to satisfy the requirement for Allocated Parking Spaces for each Building in the Project shown on Exhibit "D" of the Declaration. By way of example, the Building Lot Owners entitled to use the Common Parking Areas located on Lot 4 are the Building Lot Owners of Lot 4, Lot 14 and Lot 20, the Building Lot Owners entitled to use the Common Parking Areas located on Lot 20 are the Building Lot Owners of Lot 4, Lot 13, Lot 14 and Lot 20."

2. Parking; Common Parking Areas; Parking Regulations. Section 7.2(f) of the Declaration is hereby amended and restated as follows:

"(f) Each Building Lot Owner shall be responsible for constructing or otherwise causing the construction of all parking spaces on a Common Area Lot and/or upon such Owner's Building Lot, as necessary to satisfy all Laws in connection with the construction of a Building on such Owner's Lot."

3. Ratification. The Declaration, except as amended by this Fifth Amendment, is hereby ratified and confirmed, and except as herein expressly provided, all the terms and provisions of the Declaration remain unchanged and in full force and effect.

[SIGNATURES ON NEXT PAGE]

IN WITNESS WHEREOF, Declarant has signed and made this Fifth Amendment as of the date first above written.

DECLARANT

SANTA BARBARA REALTY DEVELOPMENT, L.L.C.,
a Delaware limited liability company

By: SRG Santa Barbara,
a Delaware limited liability company,
Management Member

By: Hagestad Enterprises,
a California general partnership,
its Operating member

By: Hagestad Management Company,
a California corporation,
its Managing General Partner

By: /s/ Russell A. Goodman
Russell A. Goodman
Its: Vice President

ACKNOWLEDGMENT

A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached, and not the truthfulness, accuracy, or validity of that document.

State of California)
County of VENTURA)

On 03-24-2016, 2016, before me, NALYN A. WIRATUNGA, a notary public, personally appeared RUSSELL A. GOODMAN, who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature /s/ Nalyn A Wiratunga (Seal)

NALYN A. WIRATUNGA
Commission # 1982149
Notary Public - California
Ventura County
My Comm. Expires Jul 12, 2016

RECORDING REQUESTED BY
CHICAGO TITLE

2014-0016612

RECORDING REQUESTED BY
AND WHEN RECORDED MAIL TO:

Santa Barbara Realty Holding Company, L.L.C.
c/o SARES Regis Group
996 S. Seaward Avenue
Ventura, CA 93001
Attention: Mr. Russ Goodman

Recorded
Official Records
County of
Santa Barbara
Joseph E. Holland
County Clerk Recorder

08:00AM 15-Apr-2014

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Page 1 of 8

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FOURTH AMENDMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK

THIS FOURTH AMENDMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK ("**Fourth Amendment**") is made as of April 15, 2014, by SANTA BARBARA REALTY DEVELOPMENT, L.L.C., a Delaware limited liability company ("**SBRD**") with reference to the following:

R E C I T A L S :

A. On April 27, 2009, that certain Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park was recorded in the Official Records of Santa Barbara County, California ("**Official Records**") as Instrument No. 2009-0023212 (the "**Original Declaration**"), as amended by that certain First Amendment to Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park (the "**First Amendment**") recorded in the Official Records on December 1, 2011 as Instrument No. 2011-0069878.

B. Pursuant to the First Amendment, SBRD assumed all of the rights and obligations of Santa Barbara Realty Holding Company, LLC and became the"Declarant" under the Original Declaration. SBRD thereafter caused (i) that certain Second Amendment to Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park (the "**Second Amendment**") to be recorded in the Official Records on December 13, 2013 as Instrument No. 2013-0077957 and (ii) that certain Third Amendment to Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park (the "**Third Amendment**") to be recorded in the Official Records on or concurrently with the recordation of this Fourth Amendment. The Original Declaration, as amended by the First Amendment, the Second Amendment and the Third Amendment, shall be referred to herein collectively as the "**Declaration**". The Declaration encumbers the Project.

C. Capitalized terms used but not defined herein shall have the meanings given such terms in the Declaration.

D. On October 15, 2013, the City approved and adopted by Ordinance No. 13-04 that certain Cabrillo Business Park Specific Plan (12-163-SP) (as amended from time to time, the "**Specific Plan**"). The Specific Plan facilitates the flexible build-out and streamlined review of development within the Project and provides the procedures by which the vested rights for development of the Project are implemented, including, but not limited to, those certain processes by which individual Improvements obtain "Project Clearance", "Map Revision" and/or "Transfers of Vehicle Trip Allowance" (as such terms are defined in the Specific Plan) are approved (hereinafter,"**Individual Project(s)**").

E. In recognition that the Individual Project approval of a Lot may possibly include, among other things, adjustments to the Deemed Area of Land, the Building Floor Area, the location and depiction of Common Areas within the Project, and proportionate shares of Assessments and Common Expenses, Declarant desires to incorporate the Specific Plan into the Declaration in order to provide for the efficient and automatic amendment of certain terms and provisions of the Declaration upon a Lot obtaining each Individual Project approval pursuant to the Specific Plan and to effectuate certain other amendments to the Declaration, as further described herein.

F. Article 14 of the Declaration allows for the amendment of the Declaration by a written instrument duly recorded in the Official Records after being duly signed and acknowledged by those Owners holding at least seventy-five percent (75%) of the Members' voting power.

G. As of the date hereof, Declarant holds at least seventy-five percent (75%) of the Members' voting power.

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Declaration is amended as follows.

1. Incorporation of Specific Plan. The Specific Plan is hereby incorporated by reference as if fully set forth herein.

2. Traffic Trips. As provided in the Specific Plan, each Lot has been allocated a designated number of average traffic trip counts per day by the City. For purposes of establishing the designated number of average traffic trips per day for each Lot as of the date hereof, the attached Exhibit E is hereby added to the Declaration.

3. Individual Project Review and Approval.

a. Conceptual Individual Project Review. Prior to the submittal of any Individual Project to the City for review and approval, the Owner(s) of the affected Lot(s) shall submit an Application to the Committee for review and approval in accordance with Article 6 of the Declaration. In addition to the requirements for the Application as described in Article 6 of the Declaration, the Application shall include all materials required by the City. Following the Committee's approval of the Application, the Owner shall be permitted to submit the Individual Project to the City for review and approval. Notwithstanding anything to the contrary set forth in Section 6.4 of the Declaration, an Owner shall not be required to commence construction of its improvements within the six (6) month timeframe described therein, but shall be required to commence construction within the timeframes required by the City.

b. Final Individual Project Review. Owner shall keep the Committee apprised if the City requires any substantial changes to the Application approved by the Committee as provided in subparagraph 3(a) above, and if there are substantial changes to the approved Application, the changes shall be submitted to the Committee for approval as provided in Article 6. Upon receiving final approval from the City for the Individual Project pursuant to the Specific Plan and prior to obtaining final building permits and/or recording any approvals, a copy of the approved Individual Project shall be submitted by Owner to the Association for its files.

c. Effect of Individual Project Approval Under Specific Plan. Upon receipt of both the Application approval from the Committee under subparagraph 3(a) above and Individual Project approval from the City pursuant to the Specific Plan and in accordance with subparagraph 3(b) above, the following terms and provisions of the Declaration shall be deemed automatically amended by, and consistent with, such Individual Project approval without the necessity of recording an amendment to this Declaration in the Official Records:

i. Exhibit B-2 to the Declaration;

ii. Exhibit C to the Declaration;

iii. Exhibit D to the Declaration;

iv. Exhibit E to the Declaration;

v. Notwithstanding anything to the contrary in Article 8 of the Declaration, the location and depiction of Common Areas within the Project; and

vi. Notwithstanding anything to the contrary in Article 12 of the Declaration, the location and depiction of Easements within the Project.

Revised copies of Exhibit B-2, Exhibit C, Exhibit D and Exhibit E, as modified from time to time to reflect updated information pursuant to any and all Individual Project approvals, shall be kept on file with the Association and by the City in accordance with the Specific Plan. To the extent there is any inconsistency with the information for Exhibit B-2, Exhibit C, Exhibit D or Exhibit E, as contained in the Declaration, the information on file with the Association and the information in the Specific Plan (as amended), the information in the Specific Plan (as amended) on file with the City shall control as to Specific Plan matters and the information on file with the Association shall control as to the Declaration. In furtherance of the foregoing, the Operator shall have the right, but not the obligation, to record an amendment to the Declaration to incorporate any such revised Exhibit B-2, Exhibit C, Exhibit D and Exhibit E; provided, however, that the Declaration shall be automatically amended by any such Individual Project approval of a Lot notwithstanding the Operator's election not to record any such amendment following such Individual Project approval.

4. Effect of Project Clearance Expiration. In the event that an Individual Project approval expires in accordance with the Specific Plan, any and all prior automatic amendments to the Declaration associated with such Individual Project (whether recorded or not) pursuant to Section 3 above shall automatically be tolled with respect to their use until such time that the Individual Project approval is revived or a new Individual Project approval for the Lot is obtained (provided that any automatic modifications made to reflect the legal description of a Lot and/or the square footage of a Lot and/or the traffic trips shall not be tolled as provided above and shall remain in full force and effect).

5. Definitions. In addition to the modifications to the exhibit references in Article 27 as provided above, the following definitions set forth in Article 27 of the Declaration are hereby modified as follows:

a. Building. Any structure now or hereafter constructed on a Lot which is intended for human occupancy including, without limitation, the eight (8) existing Buildings and contemplated Buildings approved from time to time in accordance with the Development Agreement and Specific Plan.

b. Development Agreement. The following language is hereby inserted into the end of the definition of "Development Agreement": ", as previously amended by that certain First Amendment to Development Agreement dated June 21, 2011 and recorded July 22, 2011 as Instrument No. 2011 -0041778, and that certain Second Amendment to Development Agreement dated October 15, 2013 and recorded December 5, 2013 as Instrument No. 2013-0076544, and as subsequently amended from time to time."

6. City Design Review Board.

a. The last sentence of Section 3.1 of the Declaration is hereby deleted in its entirety and replaced with the following: "Notwithstanding anything to the contrary contained in this Article 3, all Improvements within the Project shall be subject to Individual Project approval consistent with the Specific Plan and any required approvals by the City Design Review Board; any approvals by the Committee shall not be construed as an Individual Project approval by the City or the City Design Review Board, nor shall an Individual Project approval by the City and the City Design Review Board constitute approval by the Committee."

b. All references to the "City Design Review Board" or the "Design Review Board" in Section 3.9 of the Declaration are hereby deleted and replaced with "City Design Review Board/Specific Plan".

7. Permitted Uses. The following language is hereby inserted at the end of the first sentence of Section 5.1 of the Declaration: "and (c) any applicable unexpired Individual Project approval for the Lot upon which such Building is located."

8. Development Requirements of City. The following language is hereby inserted at the end of the first sentence of Section 6.8 of the Declaration:"and the Specific Plan."

9. Estoppel Certificate. The first sentence of Section 25.3 of the Declaration is hereby deleted in its entirety and replaced with the following: "Each Owner and Mortgagee shall, upon reasonable request to Declarant, the Association, or the entity then charged with enforcement of the terms of this Declaration, be entitled to receive a statement specifying (a) the nature of any known default of such applicable Owner, (b) the Individual Project approvals of the Association on file with the Association for such applicable Owner's Lot, and (c) any information reflected in the then current governing copies of Exhibit B-2, Exhibit C, Exhibit D and Exhibit E as retained on file with the Association."

10. Ratification. The Declaration, except as amended by this Fourth Amendment, is hereby ratified and confirmed, and except as herein expressly provided, all the terms and provisions of the Declaration remain unchanged and in full force and effect.

IN WITNESS WHEREOF, Declarant has signed and made this Fourth Amendment as of the date first above written.

DECLARANT

SANTA BARBARA REALTY DEVELOPMENT, L.L.C.,
a Delaware limited liability company

By: SRG Santa Barbara,
a Delaware limited liability company,
Management Member

By: Hagestad Enterprises,
a California general partnership,
its Operating member

By: Hagestad Management Company,
a California corporation,
its Managing General Partner

By: /s/ Russell A. Goodman
Russell A. Goodman
Its: Vice President

ACKNOWLEDGMENT

State of California)
County of Ventura)

On April 10 2014, before me, Patti Burbach, Notary Public, personally appeared Russell A. Goodman, who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature /s/ Patti Burbach (Seal)

ACKNOWLEDGMENT

State of California)
County of_____)

On_____, before me, _____,
(insert name of notary)

Notary Public, personally appeared _____, who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature _____ (Seal)

EXHIBIT E

TRAFFIC TRIP COUNT ALLOCATION

[See Attached]

EXHIBIT CBP-3.1

CABRILLO BUSINESS PARK

DEVELOPMENT PLAN ENTITLEMENT MATRIX

SCENARIO: 37-SB-DP (AS MODIFIED BY 12-028-DP AM)

UCSS Facilities

					TRAFFIC ANALYSIS						
Building	Use	Lot#	APN	Siding Size (SF)	Pass-by/ Mixed Use%	ADT Rate	ADT Trips	AM Rate	AM Trip	PM Rate	PM Trips
PROPOSED											
Building A.1	R & D	13	073-610-001	23,864	N/A	8.11	193	1.24	30	1.08	26
Building A.2	OFFICE	13	073-610-001	23,864	N/A	11.01	262	1.55	37	1.49	36
Building B	CORP HQ	20	073-610-002	16,175	N/A	7.98	129	1.49	24	1.40	23
Building C	MAN (ITE's Lt. Indstrl.)	20	073-610-002	108,982	N/A	6.97	759	0.92	100	0.98	107
Building C-1	Accessory Use	20	073-610-002	1,739	N/A	0.00	0	0.00	0	0.00	0
Bond	MAN (ITE's Lt. Indstrl.)	12	073-610-012	4,007	N/A	6.97	27	0.92	4	0.98	4
Utility	MAN (ITE's Lt. Indstrl.)	14	073-610-003	22,000	N/A	6.97	153	0.92	20	0.98	22
Design	R & D	21	073-610-005	4,571	N/A	8.11	37	1.24	6	1.08	5
Design-A	OFFICE	21	073-610-005	4,571	N/A	11.01	50	1.55	7	1.49	7
Program	R & D	22	073-610-004	22,738	N/A	8.11	184	1.24	28	1.08	25
Program-A	OFFICE	22	073-610-004	22,738	N/A	11.01	250	1.55	35	1.49	34
1	CORP HQ	1	073-610-008	77,000	N/A	7.98	614	1.49	114	1.40	108
2	CORP HQ	1	073-610-008	40,000	N/A	7.98	319	1.49	59	1.40	56
3	WAREHOUSE	3	073-610-010	30,000	N/A	3.56	106	0.30	9	0.32	9
4.1	R & D	4	073-610-011	30,000	N/A	8.11	243	1.24	37	1.08	33
4.2	OFFICE	4	073-610-011	30,000	N/A	11.01	330	1.55	47	1.49	45
5A.1	R & D	5	073-610-022	20,000	N/A	8.11	163	1.24	25	1.08	22
5A.2	OFFICE	5	073-610-022	20,000	N/A	11.01	221	1.55	31	1.49	30
5B.1	R & D	6	073-610-023	20,000	N/A	8.11	163	1.24	25	1.08	22
5B.2	OFFICE	6	073-610-023	20,000	N/A	11.01	221	1.55	31	1.49	30
6.1	R & D	19	073-610-027	25,000	N/A	8.11	203	1.24	31	1.08	27
6.2	OFFICE	19	073-610-027	25,000	N/A	11.01	276	1.55	39	1.49	38
X.1 (VTA Only)*	TBD	19	073-610-027	TBD	N/A		314		62		55
7.1	R & D	7	073-610-024	40,000	N/A	8.11	325	1.24	50	1.08	44
7.2	OFFICE	7	073-610-024	40,000	N/A	11.01	441	1.55	62	1.49	60
8	MINI-WAREHOUSE	8	073-610-015	46,100	N/A	2.50	115	0.15	7	0.26	12

SCENARIO: 37-SB-DP (AS MODIFIED BY 12-028-DP AM)

UCSS Facilities

					TRAFFIC ANALYSIS						
Building	Use	Lot#	APN	Siding Size (SF)	Pass-by/ Mixed Use%	ADT Rate	ADT Trips	AM Rate	AM Trip	PM Rate	PM Trips
X.2 (VTA Only)*	TBD	Post-LLA 9	073-610-025**	TBD	N/A		668		97		91
UCSB Facilities Building	WAREHOUSE	Post-LLA 10	073-610-026**	NOT A PART	N/A		259		22		23
11	MINI-WAREHOUSE	11	073-610-016	55,000	N/A	2.50	137	0.15	8	0.26	15
12	SPECIALTY RETAIL	2	073-610-009	12,200	25%	44.32	540	1.33	16	2.71	24
12-A	CORP HQ	2	073-610-009	32,800	N/A	7.98	261	1.49	48	1.40	45
Greenbelt Buffer/ NE DS	N/A	15	073-610-020	0	N/A	0.00	0	0.00	0	0.00	0
Recreation	N/A	16	073-610-021	0	N/A	0.00	0	0.00	0	0.00	0
Coromar Drive	N/A	17	073-610-013	0	N/A	0.00	0	0.00	0	0.00	0
Discovery Drive	N/A	18	073-610-017	0	N/A	0.00	0	0.00	0	0.00	0
TOTAL				**818,344**			**7,963**		**1,111**		**1,078**

Notes:

* Vehicle Trip Allowance (VTA) credit from UCSB Transfer (2013): Use and Building Size to be determined (TBD). Any developed proposal using this VTA will be required to be processed via a Project Clearance (see CBP Specific Plan).

** APN (Assessor Parcel Number) any be revised post-lot Line Adjustment (post-LLA) between old/new Lots 9 and 10. Please refer to related recorded Transfer of Traffic Trip Entrance Agreement for add Information.

1004359.03/OC

999903-140004/4-9-14/SAJ/crm

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CHICAGO TITLE

2014-0016611

RECORDING REQUESTED BY
AND WHEN RECORDED MAIL TO:

Santa Barbara Realty Holding Company, L.L.C.
c/o SARES Regis Group
996 S. Seaward Avenue
Ventura, CA 93001
Attention: Mr. Russ Goodman

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Joseph E. Holland
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THIRD AMENDMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK

THIS THIRD AMENDMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK (**"Third Amendment"**) is made as of April 15, 2014, by SANTA BARBARA REALTY DEVELOPMENT, L.L.C., a Delaware limited liability company (**"SBRD"**) with reference to the following:

RECITALS:

A. On April 27, 2009, that certain Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park was recorded in the Official Records of Santa Barbara County, California (**"Official Records"**) as Instrument No. 2009-0023212 (the **"Original Declaration"**), as amended by that certain First Amendment to Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park (the **"First Amendment"**) recorded in the Official Records on December 1, 2011 as Instrument No. 2011-0069878. The Declaration encumbers the Project.

B. Pursuant to the First Amendment, SBRD assumed all of the rights and obligations of Santa Barbara Realty Holding Company, LLC and became the "Declarant" under the Declaration. SBRD thereafter caused that that certain Second Amendment to Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park (the **"Second Amendment"**) to be recorded in the Official Records on December 13, 2013 as Instrument No. 2013-0077957. The Original Declaration, as amended by the First Amendment and the Second Amendment, shall be referred to herein collectively as the **"Declaration"**.

C. Capitalized terms used but not defined herein shall have the meaning given such term in the Declaration.

D. In connection with the transfer of that certain real property described in Exhibit A, attached hereto and incorporated herein by this reference (the **"Investec Property"**) to Investec Discovery Storage, LLC, a California limited liability company, Declarant desires to effectuate certain amendments to the Declaration, as further described herein.

E. Article 14 of the Declaration allows for the amendment of the Declaration by a written instrument duly recorded in the Official Records after being duly signed and acknowledged by those Owners holding at least seventy-five percent (75%) of the Members' voting power.

F. Declarant holds at least seventy-five percent (75%) of the Members' voting power.

NOW, THEREFORE, the Declaration is amended as follows.

1. Restricted Uses. Notwithstanding anything to the contrary in the Declaration, the portion of the Project described in Exhibit B attached hereto and incorporated herein by this reference (the **"Restricted Property"**) shall not be developed, used, leased, operated, or configured as a commercial self-storage facility (the **"Self-Storage Use Restriction"**) used for purposes of leasing small-unit storage space to the public (as opposed to being constructed for purposes of personal business use that may subsequently be leased as surplus) (the "**Self-Storage Use**").

1.1. Special Provisions Lot 4. Notwithstanding the Self-Storage Use Restriction set forth above, if Deckers Outdoor Corporation (or an affiliate thereof) acquires the portion of the Restricted Property commonly known as Lot 4 of Final Map 32,053 ("Lot 4"), the Self-Storage Use Restriction shall automatically cease and terminate with respect to Lot 4, and upon request by Declarant or the owner of Lot 4, the owner of the Investec Property shall quitclaim any rights to enforce the Self-Storage Use Restriction with respect to Lot 4 within ten (10) days following the request.

1.2. Approval Rights. In furtherance of the Self-Storage Use Restriction set forth above, during the term of the Self Storage Use Restriction, neither Declarant nor any owner of a Restricted Property shall vote, or exercise any approval rights in any way in favor of any amendment to the Development Agreement or this Declaration, the effect of which would be to allow an increase in square footage for Self Storage Uses in the Project to greater than what is permitted under the Declaration and the Development Agreement as of the date hereof. The foregoing covenant shall not apply to Lot 4 following the termination of the Self Storage Use Restriction on Lot 4 as contemplated above.

1.3. Term of Restriction. The Self-Storage Use Restriction provided in this Section I shall continue only for so long as the Investec Property is utilized for a Self Storage Use (excluding temporary closures for casualty, condemnation or remodeling that is being diligently being pursued). If the Investec Property is no longer utilized for a Self Storage Use (excluding temporary closures for casualty, condemnation or remodeling that is being diligently being pursued), then the Self-Storage Use Restriction and the covenant set forth in Section 1.2 above shall automatically cease and terminate. Following any termination of the Self-Storage Use Restriction, upon request by Declarant or any other owner, the owner of the Investec Property shall quitclaim all rights to enforce the Self-Storage Use Restriction and the covenants set forth in Section 1.2 above within ten (10) days following the request.

2. Modification. Notwithstanding anything to the contrary in the Declaration, so long as the Self-Storage Use Restriction is effective as provided in Section 1 above, the Self-Storage Use Restriction will not be modified, amended or terminated without the express written consent of the owner of the Investec Property.

3. Ratification. The Declaration, except as amended by this Third Amendment, is hereby ratified and confirmed, and except as herein expressly provided, all the terms and provisions of the Declaration remain unchanged and in full force and effect.

IN WITNESS WHEREOF, Declarant has signed and made this Third Amendment as of the date first above written.

DECLARANT

SANTA BARBARA REALTY DEVELOPMENT, L.L.C.,
a Delaware limited liability company

By: SRG Santa Barbara,
a Delaware limited liability company,
Management Member

By: Hagestad Enterprises,
a California general partnership,
its Operating member

By: Hagestad Management Company,
a California corporation,
its Managing General Partner

By: /s/ Russell A. Goodman
Russell A. Goodman
Its: Vice President

EXHIBIT A

INVESTEC PROPERTY LEGAL DESCRIPTION

THE LAND REFERRED TO HEREIN BELOW IS SITUATED IN THE CITY OF GOLETA, COUNTY OF SANTA BARBARA, STATE OF CALIFORNIA, AND IS DESCRIBED AS FOLLOWS:

Lots 8 and 11 of Tract No. 32,041, in the City of Goleta, County of Santa Barbara, State of California, as per the map filed in Book 204, Pages 60 through 63 inclusive of Maps, in the Office of the County Recorded of said County.

APN# 073-610-15 & 16

EXHIBIT B
LEGAL DESCRIPTION

That certain real property situated in the City of Goleta, County of Santa Barbara, State of California, and more particularly is described as follows:

Parcel One:

Lots 4 of Tract No. 32,035, in the City of Goleta, County of Santa Barbara, State of California, as per the map filed in Book 204, Pages 54 through 57 inclusive of Maps, in the Office of the County Recorder of said County and as amended by Certificate of Correction recorded May 26, 2010 as Instrument No. 2010-28009 of Official Records of Santa Barbara County.

Parcel Two:

Lots 14 and 22 of Tract No. 32,034 in the City of Goleta, County of Santa Barbara, State of California, as per the map filed in Book 204, Pages 39 through 42 inclusive of Maps, in the Office of the County Recorder of said County.

Parcel Three:

Lots 5, 6, 7, 19 that portion of Lot 9 of Tract No. 32,046 in the City of Goleta, County of Santa Barbara, State of California, as per map filed in Book 205, Pages 11 through 15 inclusive, as filed in the Office of the County Recorder of said County.

Beginning at the southwest corner of said Lot 9;

Thence, along the boundary of said Lot 9 the following courses and distances:

Thence, 1st, North 01 04'06" West, 392.70 feet;

Thence, 2nd, North 88 55'54" East, 94.64 feet to the beginning of a curve concave to the northeast from which the radial center bears North 58 57'01" East, 84.00 feet;

Thence, 3rd, southeasterly along the arc of said curve through a central angle of 58 25'45", an arc length of 85.67 feet;

Thence, 4th, South 89 28'43" East, 23.33 feet;

Thence, 5th, South 00 14'38" West, leaving the north line of said Lot 9, 354.35 feet to the intersection with the south line of said Lot 9;

Thence, 6th, North 89 44'05" West along the south line of said Lot 9, 180.32 feet to the Point of Beginning;

W: \work\12000-12999\12919\99 Extras (Contingency)\Survey\Legal Descriptions\Lots 4-12 15-19 Exhibit.docx

Penfield & Smith

ACKNOWLEDGMENT

State of California
County of Ventura)

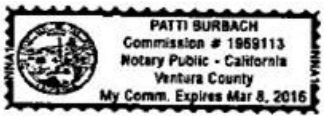
On April 10-2014 before me, Patti Burbach Notary Public
(insert name and title of the officer)

personally appeared Russell A Goodman who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the Instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature /s/ Patti Burbach **(SEAL)**



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299835-00002/11-3-11/pla/pla

RECORDING REQUESTED BY

CHICAGO TITLE

2013-0077957

RECORDING REQUESTED BY
AND WHEN RECORDED MAIL TO:

Santa Barbara Realty Holding Company, L.L.C.
c/o SARES Regis Group
996 S. Seaward Avenue
Ventura, CA 93001
Attention: Mr, Russ Goodman

Recorded
Official Records
County of
Santa Barbara
Joseph E. Holland
County Clerk Recorder

08:00AM 13-Dec-2013

REC FEE	57.00
CONFORMED COPY	2.00
AL	
Page 1 of 15	

(Space Above For Recorder's Use)

SECOND AMENDMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK

THIS SECOND AMENDMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK (**"Second Amendment"**) is made as of December **9th**, 2013, by SANTA BARBARA REALTY DEVELOPMENT, L.L.C., a Delaware limited liability company (**"SBRD"**) with reference to the following:

R E C I T A L S :

A. On April 27, 2009, that certain Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park was recorded in the Official Records of Santa Barbara County, California (**"Official Records"**) as Instrument No. 2009-0023212, as amended by that certain First Amendment to Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park (the **"First Amendment"**) recorded in the Official Records on December 1, 2011 as Instrument No. 2011-0069878 (as amended, the **"Declaration"**). The Declaration encumbers the Project. Capitalized terms used but not defined herein shall have the meaning given such term in the Declaration.

B. Pursuant to the First Amendment, SBRD assumed all of the rights and obligations of Santa Barbara Realty Holding Company, LLC and became the "Declarant" under the Declaration.

C. In connection with the transfer of that certain real property described in Exhibit A, attached hereto and incorporated herein by this reference (the **"UCSB Property"**) to THE REGENTS OF THE UNIVERSITY OF CALIFORNIA **("UCSB")**, Declarant desires to effectuate certain amendments to the Declaration, as further described herein.

D. Article 14 of the Declaration allows for the amendment of the Declaration by a written instrument duly recorded in the Official Records after being duly signed and acknowledged by those Owners holding at least seventy-five percent (75%) of the Members' voting power.

E. Declarant holds at least seventy-five percent (75%) of the Members' voting power.

NOW, THEREFORE, the Declaration is amended as follows.

1. Common Areas and Assessments.

(a) Notwithstanding anything to the contrary in the Declaration, including, without limitation, Exhibit C and Exhibit D attached thereto, the Deemed Area of Land for purposes of calculating the UCSB Property's percentage share of Common Expenses shall be Seven and 75/100 (7.75) acres.

(b) Notwithstanding anything to the contrary in the Declaration, there shall be no Common Parking Areas located on or associated with the UCSB Property, and as a result thereof, there will be no Common Parking Expenses allocated to the UCSB Property. Without limiting the generality of the foregoing, all parking areas on the UCSB Property shall be Exclusive Parking Areas. In addition, there shall be no other Common Areas on the UCSB Property other than perimeter landscaping and sidewalks and streetscapes.

(c) If UCSB does not use Common Utility Lines for the UCSB Property (for example, if UCSB is able to connect to its campus' electricity grid), then notwithstanding the provisions of Section 2.4(e) of the Declaration, UCSB shall not be obligated to pay any expenses in connection with such Common Utility Lines for the UCSB Property; provided that UCSB shall not be permitted to "opt out" of participating in the cost of the Common Water Lines and the water costs associated therewith and shall not be permitted to "opt out" of any other utility costs that benefit or are provided for the Common Areas of the Project (as opposed to being provided for the UCSB Property). Any utility charges that are allocated to the UCSB Property pursuant to the Declaration shall be based on actual readings and utilities' rates.

(d) Notwithstanding anything to the contrary in Section 2.6(a)(i) and (ii) of the Declaration, only Special Assessments that benefit the UCSB Property or the Common Area Lots may be allocated as a Special Assessment to the UCSB Property.

(e) In no event shall Capital Improvement Assessments include any costs of the initial Improvements for the Project, which expenses shall not be passed through as an Assessment pursuant to the terms of the Declaration.

2. Maximum Floor Area Allocation For Voting. Notwithstanding anything to the contrary in the Declaration, including without limitation, the provisions of Exhibit C attached thereto, for purposes of calculating UCSB's voting rights pursuant to Section 1.5 of the Declaration, the Maximum Floor Area for the UCSB Property shall be deemed to be Seventy Two Thousand Eight Hundred Seventy (72,870) square feet.

3. Future Improvements on UCSB Property. Notwithstanding the deemed Maximum Floor Area allocation for the UCSB Property set forth paragraph 2 above, except as otherwise provided in this Second Amendment, so long as the UCSB Property is owned by a public agency or UCSB, the UCSB Property shall in no event be subject to or limited by the Maximum Floor Area allocation set forth in paragraph 2 above or any other Maximum Floor Area allocation set forth in the Declaration for any other purpose, and UCSB shall not be required to obtain approval under the Declaration for increasing the interior and/or exterior floor area of the UCSB Property. Additionally, so long as the UCSB Property is owned by a public agency or UCSB, the UCSB Property shall not be subject to compliance with any architectural, design and development guidelines or review approvals set forth in the Declaration, including without limitation, Article 3 and Sections 6.1 and 6.8 thereof, except that the UCSB Property: (a) shall nevertheless be subject to the height restrictions and other restrictions set forth in that certain avigation easement recorded in the Official Records of the Santa Barbara County Recorder's Office on January 24, 1986 a Instrument No. 86-4753 (as amended); (b) shall be subject to the Committee's review and approval, which shall not be unreasonably withheld, to the extent that any proposed Improvements may have an impact on surface water drainage, and/or the fence and associated landscaping requirements for the portion of the UCSB Property adjacent to Los Caneros/Discovery Drive; and (c) shall be subject to environmental review under applicable law (for example, the California Environmental Quality Act or CEQA) and review of any other relevant agreements with governmental agencies, during which process the various governmental agencies will have an opportunity to review and comment on the potential impacts in accordance with CEQA.

4. Rules and Regulations for UCSB Property. Notwithstanding anything to the contrary in the Declaration, any Rules and Regulations adopted pursuant to the Declaration may not adversely affect the use or operation of the UCSB Property, nor restrict any other rights of UCSB; provided that the foregoing shall not limit the Operator's rights to make Rules and Regulations with respect to the Common Areas and/or UCSB's obligation to comply therewith.

5. Operator Self-Help at the UCSB Property. Notwithstanding anything to the contrary in the Declaration, (a) Operator may not exercise self-help at the UCSB Property, including, without limitation, pursuant to the provisions of Section 9.7 of the Declaration, and (b) if Operator makes any entries on the UCSB Property in the event of an emergency or in connection with exercising its rights and obligations under the Declaration, Operator shall use reasonable efforts to not interfere with the operations on the UCSB Property and shall be responsible for any damage Operator may cause to the UCSB Property. The foregoing shall not, however, be deemed to impose any limitations on Operator's rights with respect to any maintenance, repair and operation of the Common Areas.

6. Uses at UCSB Property. Notwithstanding anything to the contrary in the Declaration, so long as the UCSB Property is owned by a public agency or UCSB, (a) the requirements of Sections 5.1, 5.4 and 5.5 shall not be applicable to the UCSB Property, (b) the last sentence of Section 5.2 of the Declaration shall not be applicable to the UCSB Property, (c) the prohibition on "petroleum storage yards" and "trailer courts" set forth in the Declaration will not prevent the UCSB Property from having some fuel capacity (above ground tanks) for its vehicles or equipment and modular structures, so long as UCSB complies with all applicable laws related thereto, obtains all applicable permits and is responsible for any and all liabilities associated therewith, and (d) the UCSB Property shall only be subject to those Laws that are applicable to land owned by The Regents of the University of California.

7. UCSB Property Operations.

(a) Notwithstanding the provision of Section 7.2(h) of the Declaration, so long as the UCSB Property is owned by a public agency or UCSB, the storage and repair of motor vehicles shall be permitted on the UCSB Property (even after construction of new buildings), so long as the UCSB Property is screened in accordance with plans for the screen wall and landscaping along the UCSB Property perimeter approved by the Committee.

(b) Notwithstanding anything to the contrary in the Declaration, so long as the UCSB Property is owned by a public agency or UCSB, the UCSB Property shall not be subject to Sections 7.3, 7.5, 7.9 and 7.10 so long as the UCSB Property is screened in accordance with plans for the screen wall and landscaping along the UCSB Property perimeter approved by the Committee.

(c) Notwithstanding anything to the contrary in the Declaration, so long as the UCSB Property is owned by a public agency or UCSB, the UCSB Property shall not be subject to the provision of Section 7.11.

(d) Notwithstanding anything to the contrary in the Declaration, (a) the UCSB Property shall only be required to be maintained in good condition and repair consistent with the condition in which UCSB acquired the UCSB Property; provided that if the UCSB Property is redeveloped as a new facility, it shall be maintained in first-class condition and repair as required in the Declaration; and (b) in no event shall UCSB be required to obtain the Committee approval to change the exterior paint color of its Improvements so long as the exterior colors are consistent and architecturally harmonious for the balance of the Project.

8. Casualty to UCSB Property. Notwithstanding anything to the contrary in the Declaration, the UCSB Property shall not be subject to the provisions of Section 9.6 of the Declaration; provided that in the event of a casualty on the UCSB Property, UCSB shall either elect to reconstruct the Improvements in a diligent manner or elect to diligently raze the Improvements and maintain the UCSB Property in a safe and unimproved condition.

9. Insurance and Indemnification.

(a) Notwithstanding anything to the contrary in the Declaration, so long as the UCSB Property is owned by a public agency or UCSB, consistent with Standing Order 100.4, the indemnification obligations of UCSB shall only be in proportion to and only to the extent that claims arise from the negligent or wrongful acts or omissions of UCSB or that of its officers, agents, employees, students, invitees and guests.

(b) Notwithstanding anything to the contrary in the Declaration, so long as the UCSB Property is owned by a public agency or UCSB, UCSB shall be permitted to satisfy any insurance requirements through a self-insurance program for the UCSB Property.

10. City Requirements. Notwithstanding anything to the contrary in the Declaration, so long as the UCSB Property is owned by a public agency or UCSB, to the extent permitted by law and subject to the provisions set forth in this Second Amendment, the provisions of Section 26 of the Declaration shall not be applicable to the UCSB Property.

11. Easements in the Project. Notwithstanding anything to the contrary in the Declaration, Declarant and Operator shall not unreasonably interfere with the use and enjoyment of the Owners of their respective Lots while exercising the easement rights set forth in Article 12 of the Declaration.

12. General Changes.

(a) Exhibit C attached to the Declaration is hereby deleted in its entirety and replaced with Exhibit C attached hereto and incorporated herein by this reference.

(b) Exhibit D attached to the Declaration is hereby deleted in its entirety and replaced with Exhibit D attached hereto and incorporated herein by this reference.

(c) Any amendment of the Declaration that conflicts with the terms of this Second Amendment shall not be effective as to the UCSB Property unless UCSB consents to such amendment by written document signed by an authorized officer of UCSB.

[SIGNATURE PAGE TO FOLLOW]

IN WITNESS WHEREOF, Declarant has signed and made this Second Amendment as of the date first above written.

DECLARANT

SANTA BARBARA REALTY DEVELOPMENT, L.L.C.,
a Delaware limited liability company

By: SRG Santa Barbara,
a Delaware limited liability company,
Management Member

By: Hagestad Enterprises,
a California general partnership,
its Operating member

By: Hagestad Management Company,
a California corporation,
its Managing General Partner

By: /s/ Russell A. Goodman
Russell A. Goodman
Its: Vice President

THE CITY OF GOLETA JOINS IN THE EXECUTION OF THIS SECOND AMENDMENT FOR PURPOSES OF ACKNOWLEDGING ITS CONSENT THERETO PURSUANT TO THE TERMS OF THE DECLARATION.

CITY OF GOLETA
/s/ Daniel A. Singer.

ACKNOWLEDGMENTS

State of California)
County of Ventura)

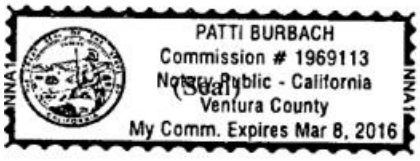
On December 5, 2013, before me, Patti Burbach Notary Public,
(insert name of notary)
Notary Public, personally appeared Russell A Goodman, who proved to me on the basis of satisfactory evidence to be the person (s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity (ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature /s/ Patti Burbach

(Seal)



State of California)
County of *Santa Barbara*)

On December 9, 2013, before me, Donna L. Quaglia, Notary Public,
(insert name of notary)
Notary Public, personally appeared Daniel Singer, who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature /s/ Donna L. Quaglia

(SEAL)

EXHIBIT A
UCSB LEGAL DESCRIPTION

LEGAL DESCRIPTION OF UCSB PROPERTY

THE LAND REFERRED TO HEREIN BELOW 15 SITUATED IN THE CITY OF GOLETA, COUNTY OF SANTA BARBARA, STATE OF CALIFORNIA, AND IS DESCRIBED AS FOLLOWS:

Lots 9 and 10 of Tract No. 32,046 in the City of Goleta, County of Santa Barbara, State of California, as per map filed in Book 205, Pages 11 through 15 inclusive, as filed in the Office of the County Recorder of said County.

EXCEPTING therefrom that portion of Lot 9 of said Tract No. 32,046 described as follows:

Beginning at the Southwest comer of said Lot 9;

Thence, along the boundary of said Lot 9 the following courses and distances:

Thence, 1st, North 01°04’06” West, 392.70 feet;

Thence, 2nd, North 88°55’54” East, 94,64 feet to the beginning of a curve concave to the Northeast from which the radial center bears North 58°57’01” East, 84.00 feet;

Thence, 3rd, Southeasterly along the arc of said curve through a central angle of 58°25’45”, an arc length of 85.67 feet;

Thence, 4th, South 89°28’43” East, 23.33 feet;

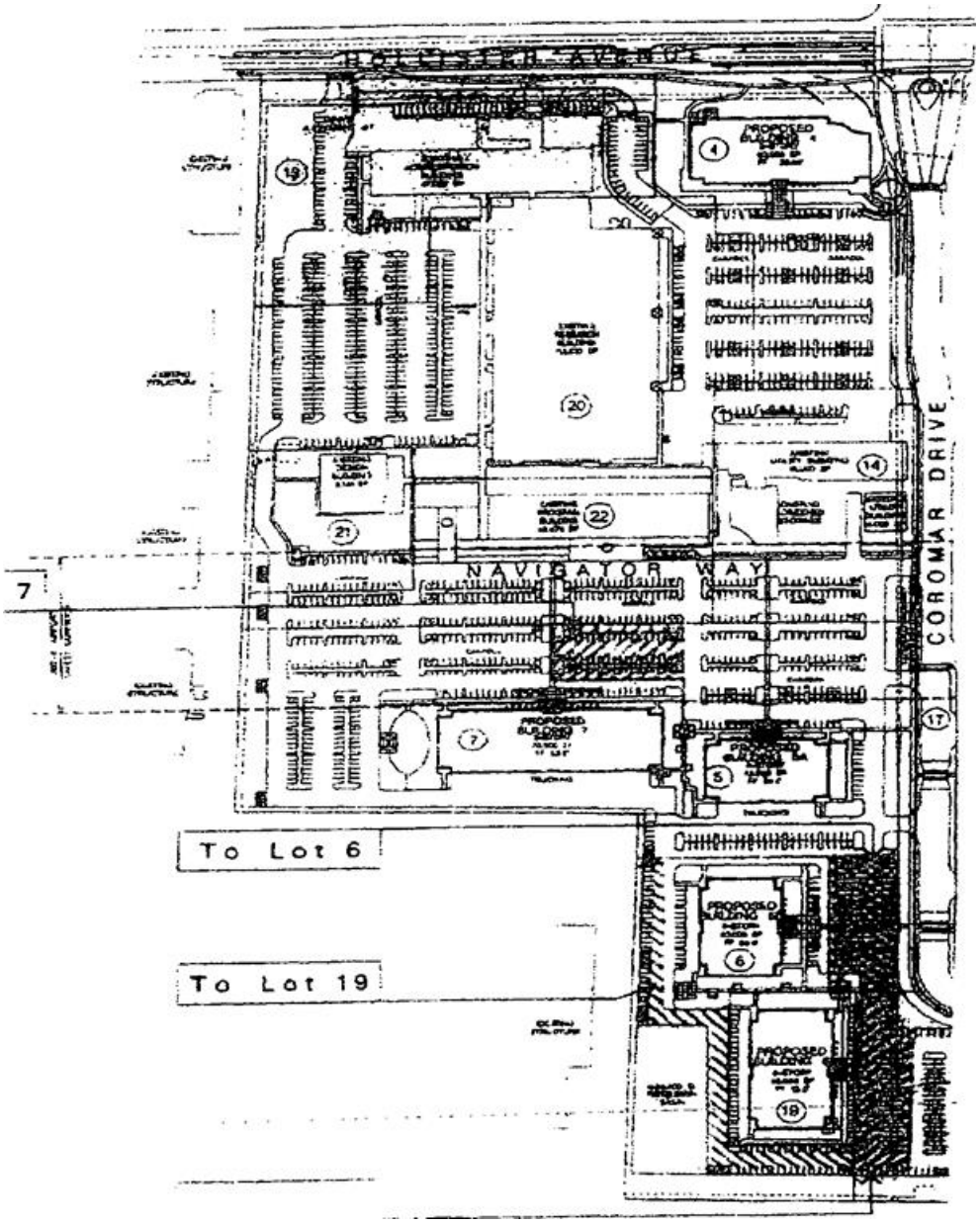
Thence, 5th, South 00°14’38” West, leaving the North line of said Lot 9, 354.35 feet to the intersection with the South line of said Lot 9;

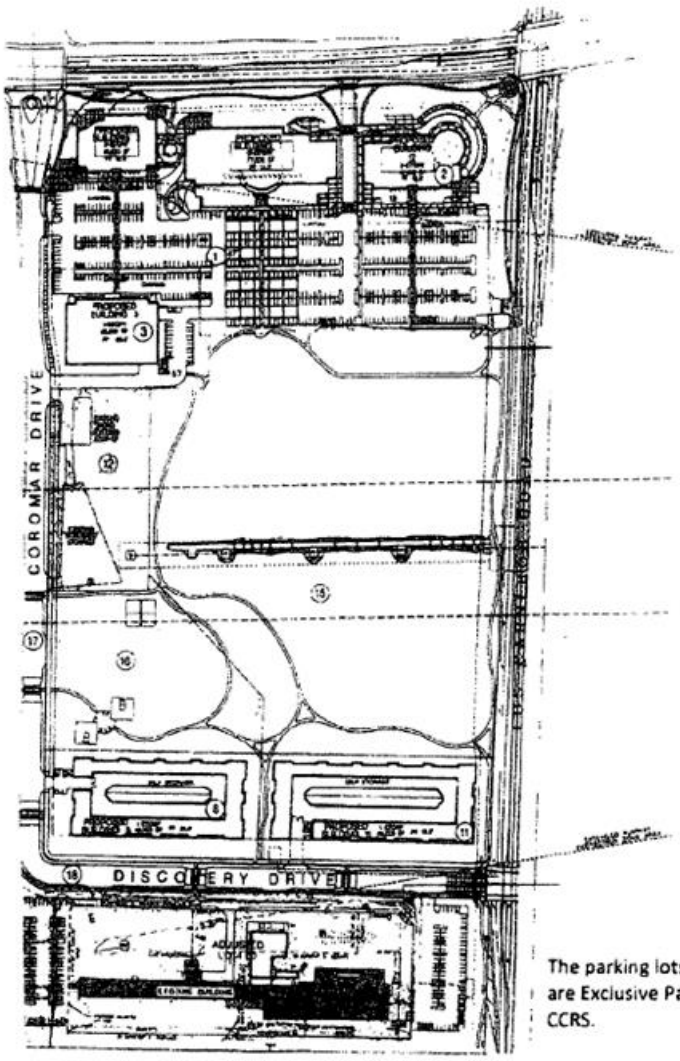
Thence, 6th, North 89°44’05” West, along the South line of said Lot 9, 180.32 feet to the point of beginning.

APN: 073-610-26 & PTN 073-610-25

EXHIBIT "B-2"

Conceptual Site Plan with Parcel Plan Showing
Potential Full Build-Out of the Project
With Parking on Parcel, including Parking provided by Easement





Conceptual Site Plan
Exhibit "B-2"

The parking lots on Lots 1-3, 8, 10, 11 and 12 are Exclusive Parking Areas as defined in the CCRS.

Parking that will be committed to other Lots By easement is shown in hatch and cross-hatch patterns.

EXHIBIT "C"

DESCRIPTION OF LOTS; MAXIMUM FLOOR AREAS

"**Lot 1**" - The land comprising Lot 1 consisting of approximately 9.16 acres of land upon which Declarant contemplates constructing new improvements consisting of two buildings, proposed Building 1 presently contemplated to consist of a two story office building to contain a maximum of 77,000 square feet of Floor Area ("**Building 1**"), proposed Building 2 presently contemplated to consist of a two story office building to contain a maximum of 40,000 square feet of Floor Area ("**Building 2**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2**".

"**Lot 2**" - The land comprising Lot 2 consisting of approximately 2.33 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of one building, a proposed office building to contain a maximum of 45,000 square feet of Floor Area ("**Building 12**), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2**"

"**Lot 3**" - The land comprising Lot 3 consisting of approximately 2.38 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a warehouse facility to contain a maximum of 30,000 square feet of Floor Area ("**Building 3**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"**Lot 4**" - The land comprising Lot 4 consisting of approximately 3.75 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 60,000 square feet of Floor Area ("**Building 4**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"**Lot 5**" - The land comprising Lot 5 consisting of approximately 5.33 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 40,000 square feet of Floor Area ("**Building 5**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"**Lot 6**" - The land comprising Lot 6 consisting of approximately 3.76 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 40,000 square feet of Floor Area ("**Building 6**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"**Lot 7**" - The land comprising Lot 7 consisting of approximately 4.95 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 80,000 square feet of Floor Area ("**Building 1**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"**Lot 8**" - The land comprising Lot 8 consisting of approximately 2.75 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a one story self storage facility to contain a maximum of 46,100 square feet of Floor Area ("**Building 8**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"**Lot 9**" - The land comprising Lot 9 consisting of approximately 1.605 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of To Be Determined square feet of Floor Area ("**Building 9**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"** The originally planned 70,000 sf of office buildings entitlements planned for the Site are being retained by the Declarant to be used in future development within the project in accordance with the project Specific Plan.

"**Lot 10**" - The land comprising Lot 10 consists of approximately 7.749 acres of land, upon which are located buildings totaling 72,870 sf, as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**, which property is being sold to the Regents of the University of California (University). Upon conveyance of the property, University will retain 259 ADT and 22 a.m. PHT and 23 p.m. PHT (peak hour trips) for its 72,870 SF of warehouse and related uses. The originally planned 60,000 sf of office building entitlements planned for the Lot 10 are being retained by the Declarant to be used in future development within the Project in accordance with the Specific Plan less the traffic trips (referenced above) retained by the University.

"**Lot 11**" - The land comprising Lot 11 consisting of approximately 3.13 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a one story self storage facility to contain a maximum of 56,000 square feet of Floor Area ("**Building 11**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B -2"**

"**Lot 12**" - The land comprising Lot 12 consisting of approximately 2.32 acres of land upon which is located an approximately 4,007 square foot bond building and existing screened storage area (the "**Lot 12 Improvements**") comprising the maximum Floor Area for Lot 12, as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"**Lot 13**" - The land comprising Lot 13 consisting of approximately 4.55 acres of land upon which is located an approximately 47,728 square foot administration building (the "**Lot 13 Administration Building**") comprising the maximum Floor Area for Lot 13, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"**Lot 14**" - The land comprising Lot 14 consisting of approximately 2.96 acres of land upon which is located an approximately 22,000 square foot utility building ("**Building 14**") comprising the maximum Floor Area for Lot 14, and existing screened storage area and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"**Lot 15**" - of the Project presently contains the land comprising Lot 15 consisting of approximately 15.31 acres of land which is to constitute green belt, buffer area within the Project (the "**Open Space**") as depicted on the Conceptual Site Plan attached hereto as**Exhibit "B-2"**.

"**Lot 16**" - of the Project presently contains the land comprising Lot 16 consisting of approximately 3.33 acres of land which is to constitute recreational area within the Project (the "**Recreation Area**") as depicted on the Conceptual Site Plan attached hereto as**Exhibit "B-2"**.

"**Lot 17**" - of the Project presently contains the land comprising Lot 17 consisting of approximately 2.35 acres of land which shall comprise an interior private street or streets or portions thereof within the Project as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"**Lot 18**" - of the Project presently contains the land comprising Lot 18 consisting of approximately 1.96 acres of land which shall comprise an interior private street or streets or portions thereof within the Project as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"**Lot 19**" - of the Project presently contains the land comprising Lot 19 consisting of approximately 1.58 acres of land on which Declarant plans to build an approximately 50,000 square foot building as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"**Lot 20**" - The land comprising Lot 20 consisting of approximately 6.87 acres of land upon which is located an approximately 125,157 square foot manufacturing building ("**Building 20**") comprising the maximum Floor Area for Lot 20, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**. Owner of Building 20 was approved by the City Council for an increase of approximately 11,827 sf outside of the Development Agreement.

"**Lot 21**" - The land comprising Lot 21 consisting of approximately 1.49 acres of land upon which is located an approximately 9,141 square foot design building ("**Building 21**") comprising the maximum Floor Area for Lot 21, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"**Lot 22**" - The land comprising Lot 22 consisting of approximately 3.29 acres of land upon which is located an approximately 45,476 square foot program building ("**Building 22**") comprising the maximum Floor Area for Lot 22, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

EXHIBIT "D"

Schedule of Deemed Land Area, Allocated Common Parking Spaces

And Common Area Maintenance Percentages

Lot	Building	Maximum Building Square Footage**	Deemed Land Area*	Allocated Parking Spaces**	Parking Ratio - Per 1,000 sq. ft. of Improvements*	Common Expenses Percentage Based on Deemed Land Area:
	New Construction					
1	Building 1 & 2	117,000 sf	7.37 acres	358	3.06	10.6%
2	Building 12	45,000 sf	4.41 acres	138	3.06	6.4%
3	Building 3	30,000 sf	2.01 acres	57	1.90	2.9%
4	Building 4	60,000 sf	3.74 acres	180	3.02	5.4%
5	Building 5a	40,000 sf	3.01 acres	123	3.08	4.3%
6	Building 5b	40,000 sf	2.62 acres	125	3.12	3.8%
19	Building 6	50,000 sf	3.99 acres	150	3.00	5.8%
7	Building 7	80,000 sf	5.59 acres	247	3.09	8.0%
8	Building 8	46,100 sf	2.79 acres	6	0.13	4.0%
9	Building 9	TBD	1.60 acres	TBD	TBD	2.3%
10	Building 10	Not Applic	7.75 acres	Not Applic	Not Applic	11.2%
11	Building 11	55,000 sf	3.11 acres	3	0.05	4.5%
	Declarant bank of SF	**	none			
	Existing Buildings					
12	Bond Building	4,000 sf	2.32 acres	N/A	N/A	3.3%
13	Building 13	47,700 sf	4.27 acres	161	3.37	6.2%
14	Building 14	22,000 sf	2.94 acres	71	3.22	4.2%
20	Building 20	125,157 sf	7.18 acres	337	2.97	10.3%
21	Building 21	9,100 sf	1.51 acres	31	3.44	2.2%
22	Building 22	45,500 sf	3.19 acres	142	3.12	4.6%
	Subtotal		**69.38 net acres**			
15, 16, 17 & 18	Common Area Lots		22.72 acres			
	Dedications		0.15 acres			
	Total	**936,000 sf**	**92.25 acres**	**2519 spaces**	**2.69 avg.**	**100%**

* Based upon actual Building Lot acreage, (as set forth on Exhibit "C"), ***plus*** the area of additional land, if any, which is attributable to parking areas allocated for use by the Owner, Occupants and Permittees of such Building Lot by easement from another Building Lot in the Project, and ***less*** the land area, if any, which is located upon such Building Lot and which is allocated by easement for parking use by the Owners, Occupants and Permittees of another Building Lot in the Project.

** Based upon permitted/intended use as indicated in the Development Agreement. Per 2nd Amendment to Development Agreement including new Specific Plan for project and including transfer of Lot 10 out of project for development, the sf relative to the approved development of 130k sf of office on Lots 9 and 10 (less traffic trips impacts of 23 pm PHT) can be transferred to other Declarant owned land in the project subject to Planning Department approval.
Lot 10 remains responsible for its share of Common Expenses as described in Paragraph 1 of the Second Amendment to CCRs.

939501.02/OC
299835-00002/11-3-11/pla/pla

DOCSOC/1524155v2/100550-0042

RECORDING REQUESTED BY
CHICAGO TITLE

2011-0069878

RECORDING REQUESTED BY	Recorded	REC FEE	57.00
AND WHEN RECORDED MAIL TO:	Official Records		
	County of	CONFORMED COPY	2.00
	Santa Barbara		
SARES Regis Group	Joseph E. Holland		
300 Esplanade, Suite 1110	County Clerk Recorder		
Oxnard, California 93036		KM	
Attention: Cabrillo Business Park Manager	08:00AM 1-Dec-2011	Pass 1 of 15	

(Space Above For Recorder's Use)

FIRST AMENDMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK

This FIRST AMENDMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK ("**First Amendment**") is made as of November 30, 2011, by SANTA BARBARA REALTY HOLDING COMPANY, LLC, a Delaware limited liability company ("**SBRHC**") and SANTA BARBARA REALTY DEVELOPMENT, L.L.C., a Delaware limited liability company ("**SBRD**") with reference to the following:

RECITALS:

A. On April 27, 2009, that certain Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park was recorded in the Official Records of Santa Barbara County, California ("**Official Records**") as Instrument No. 2009-0023212 ("**Declaration**"). The Declaration encumbers the property described in Exhibit "A" attached hereto (the "**Project**"). Capitalized terms used but not defined herein shall have the meaning given such term in the Declaration.

B. SBRHC was the original Declarant under the Declaration. SBRHC has since transferred to SBRD one or more Lots comprising a portion of the Project.

C. SBRHC desires to transfer to SBRD the rights and obligations, and SBRD desires to accept and assume from SBRHC the rights and obligations, of Declarant under the Declaration.

D. SBRHC and SBRD further desire to effectuate certain other amendments to the Declaration, as further described herein.

E. Article 14 of the Declaration allows for the amendment of the Declaration by a written instrument duly recorded in the Official Records after being duly signed and acknowledged by those Owners holding at least seventy-five percent (75%) of the Members' voting power.

F. SBRHC and SBRD together hold at least seventy-five percent (75%) of the Members' voting power.

NOW, THEREFORE, the Declaration is amended as follows.

1. Section 2.4(a). Section 2.4(a) of the Declaration is hereby deleted in its entirety and the following language inserted in lieu thereof:

"Lots 1, 2, 3, 8, 11 and 12 and other Exclusive Use Area Expenses. All Exclusive Use Area Expenses shall be paid directly by the Owner(s) entitled to the use and benefit of such Exclusive Use Area(s), but to the extent any such Exclusive Use Area Expenses are administered and incurred by the Operator they shall be assessed by the Operator to the Owner(s) entitled to the use and benefit of such Exclusive Use Area(s) as a Regular Assessment. To the extent any such Exclusive Use Area(s) is (are) shared by more than one Owner as reasonably determined by the Operator, the Owners entitled to the use and benefit of such Exclusive Use Area(s) shall share all Exclusive Use Expenses attributable to such Exclusive Use Area(s) on an equitable basis based upon the respective usage of or benefits derived from such Exclusive Use Area and Exclusive Use Area Improvements as determined by the Operator or by mutual agreement of such Owners. Without limiting the foregoing, and by way of example, all costs and expenses incurred by the Operator and not directly paid for by the Owners or Occupants of Lots 1, 2, 3, 8, 11 or 12, respectively, for their Exclusive Parking Areas, shall be assessed solely to the Owner(s) of such Lots, as applicable, as Exclusive Use Area Expenses of such Owner(s), respectively."

2. Sections 7.2 (c) and 12.6(a) and definition of Reserved Parking Spaces Notwithstanding anything to the contrary set forth in Sections 7.2(c) or 12.6(a) of the Declaration or the definition of Reserved Parking Spaces, there shall be no limit on the percentage of Allocated Parking Spaces that Declarant or the Operator may establish as Reserved Parking Spaces for any Building Lot.

3. Section 7.2(i)(ii). Section 7.2(i)(ii) is deleted in its entirety and the following language inserted in lieu thereof:

"(ii) Mitigation Measures. If any overburdening of the Common Parking Areas occurs as provided in (i) above, the Operator shall take the following mitigation measures in the following order as needed: (1) reduce or eliminate any excess parking use by any parties who are not Owners, Occupants or Permittees of the Project, if any; (2) reduce or eliminate the use by any Owner or its Occupants found to be overburdening the Common Parking Areas; and/or (3) take any other reasonable action. If, after a reasonable period of time, not to exceed four (4) months from commencement of one or more of the mitigation measures specified above, Operator has not been able to reduce or eliminate the overburdening of the Common Parking Areas, Operator or Declarant shall have the right to establish and reserve up to one hundred percent (100%) of the total Allocated Parking Spaces allocated to a Building Lot as Reserved Parking Spaces."

4. Article 27 Definitions. The following definitions are amended as follows:

"Common Areas." The last sentence of the definition of Common Areas is hereby deleted in its entirety and the following language inserted in lieu thereof:

"Notwithstanding anything contained in this Declaration to the contrary, all Parking Areas of Lots 1, 2, 3, 8, 11 and 12 other than driveways, drive aisles, sidewalks, Common Utilities, Common Drainage and Facilities and Common Signage located on such Lots shall constitute Exclusive Use Areas for the exclusive use of the Owner(s) and Occupants and Permittees of Lots 1, 2, 3, 8, 11 and 12, respectively, and shall not constitute part of the Common Areas of the Project."

"Exclusive Parking Areas." The first sentence of the definition of Exclusive Parking Areas is hereby deleted in its entirety and the following language inserted in lieu thereof:

"all Parking Areas situated within any Lot in the Project which are expressly reserved and dedicated solely for use by the Owner, Occupants and Permittees of the Building situated upon such Lot and which are designated as Exclusive Use Areas of the Owner of such Lot and are therefore maintained and repaired by such Owner and not the Association as provided in this Declaration, including without limitation, all Parking Areas situated on Lots 1, 2, 3, 8, 11 and 12."

"Exclusive Use Areas." The first sentence of the definition of Exclusive Use Areas is hereby deleted in its entirety and the following language inserted in lieu thereof:

> "Those portions of the Project designated as Exclusive Use Areas from time to time by Declarant or the Operator in writing for the exclusive use of one or more, but not all, Owners and their respective Occupants and Permittees including, without limitation, each Building within the Project; and all Building Appurtenances and similar areas immediately appurtenant to an Owner's Building(s) and the Private Water Lines serving such Building which are designated or approved by the Operator as for the exclusive use of such Owner(s) and such Owner(s)' Occupants and Permittees and are to be used, maintained and/or repaired by the Owner(s) and Occupant(s) of such Building(s) as provided herein, including, without limitation, the Exclusive Parking Areas located on Lots 1, 2, 3, 8, 11 and 12 and those other areas designated as Exclusive Use Areas on the Site Plans attached hereto as **Exhibit "B-2"**."

"Owner." The definition of Owner is hereby deleted in its entirety and the following language inserted in lieu thereof:

> "(i) Any Person (including Declarant) who from time to time holds fee title to any Lot within the Project, and (ii) an Occupant of an Owner's entire Lot (or of all of the usable area within the Building(s) on the Lot): (a) pursuant to a lease or sublease which, as of the date of the Owner's designation of the Occupant as Owner, has a remaining term of ten (10) years or more, not including periods for which the term thereof may be extended by unexercised options to extend; and (b) designated as such by the Owner of the Lot pursuant to Section 1.3. If an Owner shall designate an Occupant as Owner for purposes of this Declaration, then the actual fee Owner shall not be deemed to be an Owner of such Lot during the period of such lease or sublease or such period of time as which the Lot Owner shall designate such Occupant as Owner, whichever is shorter. If the ownership of Improvements on a Lot shall be severed from the ownership of the land comprising such Lot, the Owner of the Improvements shall be deemed an Owner hereunder and shall be entitled to act on behalf of the Owner of the land for all purposes hereunder so long as such ownership rights shall be segregated."

5. Assignment and Assumption of Declarant Rights. SBRHC hereby assigns to SBRD the rights and obligations of Declarant under the Declaration and SBRD hereby accepts and assumes from SBRHC the rights and obligations of Declarant under the Declaration.

6. Exhibits. Exhibit "B-2", Exhibit "C" and Exhibit "D" of the Declaration are hereby deleted and the Exhibits attached hereto as Exhibit "B-2," Exhibit "C" and Exhibit "D" inserted in lieu thereof.

IN WITNESS WHEREOF, SBRHC and SBRD have signed and made this First Amendment as of the date first above written.

SBRHC

SANTA BARBARA REALTY HOLDING COMPANY, LLC,

a Delaware limited liability company

By: SRG Santa Barbara, LLC,
a Delaware limited liability company
Its: Managing Member

By: /s/ Russell A. Goodman
Name: Russell A. Goodman
Title: Authorized Member

By: Hagestad Enterprises,
a California general partnership
Its: Operating member

By: Hagestad Management Company,
a California corporation
Its: Managing General Partner

By: /s/ John S. Hagestad
John S. Hagestad
Its: President

SBRD

SANTA BARBARA REALTY DEVELOPMENT, L.L.C.,
a Delaware limited liability company

By: SRG Santa Barbara,
a Delaware limited liability company
Its: Managing Member

By: Hagestad Enterprises,
a California general partnership,
Its: Operating member

By: Hagestad Management Company
a California corporation
Its: Managing General Partner

By: /s/ John S. Hagestad
John S. Hagestad
Its: President

CALIFORNIA ALL-PURPOSE ACKNOWLEDGMENT

State of California }
County of ORANGE

On 11/21/11 (Date) before me, Christina Sowers Notary Public (Here Insert Name and Title of the Officer),

personally appeared JOHN S. HAGESTAD (Names(s) of Signer(s)),

who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature /s/ Christina Sowers

Place Notary Seal Above — Signature of Notary Public

~~OPTIONAL~~

Though the information below is not required by law, it may prove valuable to persons relying on the document and could prevent fraudulent removal and reattachment of this form to another document.

Description of Attached Document

Title or Type of Document: FIRST AMENDEMENT TO DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT

Document Date: NOVEMBER 18, 2011 Number of Pages: 10

Signer(s) Other Than Named Above: RUSSELL A GOODMAN

Capacity(Ies) Claimed by Signer(s)

Signer's Name: John S. Hagestad
☐ Individual
☐ Corporate Officer — Title(s): President
☐ Partner — ☐ Limited ☐ General
☐ Attorney in Fact
☐ Trustee
☐ Guardian or Conservator
☐ Other:
Signer Is Representing:

RIGHT THUMBEPRINT OF SIGNER
Top of thumb here

Signer's Name:
☐ Individual
☐ Corporate Officer— Title(s):
☐ Partner — ☐ Limited ☐ General
☐ Attorney in Fact
☐ Trustee
☐ Guardian or Conservator
☐ Other:
Signer is Representing:

RIGHT THUMBEPRINT OF SIGNER
Top of thumb here

CALIFORNIA ALL-PURPOSE ACKNOWLEDGMENT

State of California

County of ORANGE

On 11/21/11 (Date) before me, Christina Sowers Notary Public (Here Insert Name and Title of the Officer),

personally appeared RUSSELL A. GOODMAN (Names(s) of Signer(s))

who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature /s/ Christina Sowers

Place Notary Seal Above — Signature of Notary Public

---------- ***OPTIONAL*** ----------

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Document Date: NOVEMBER 18, 2011 Number of Pages: 10

Signer(s) Other Than Named Above: /s/ JOHN S. HAGESTAD

Capacity(Ies) Claimed by Signer(s)

Signer's Name: _____
☐ Individual
☐ Corporate Officer — Title(s): Member
☐ Partner — ☐ Limited ☐ General
☐ Attorney in Fact
☐ Trustee
☐ Guardian or Conservator
☐ Other: _____
Signer Is Representing: _____

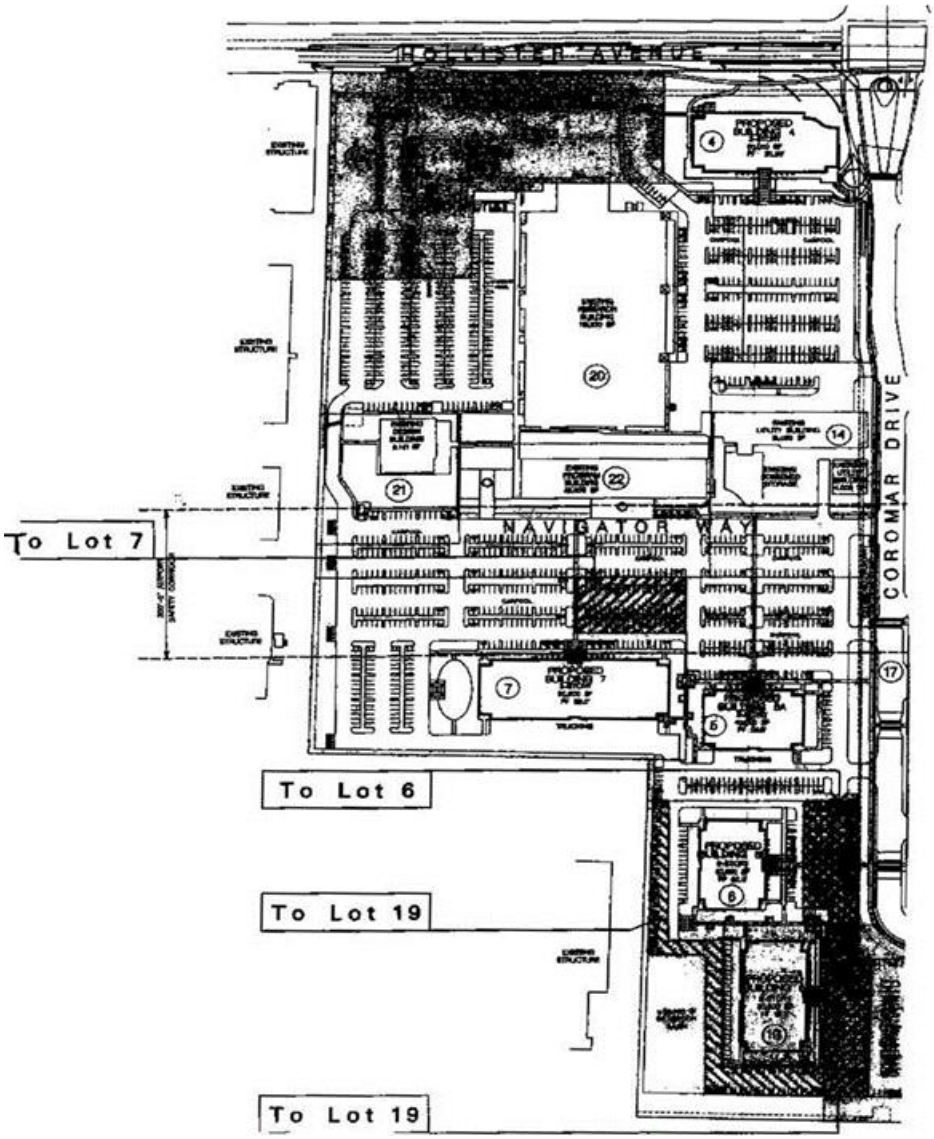
RIGHT THUMBEPRINT OF SIGNER
Top of thumb here

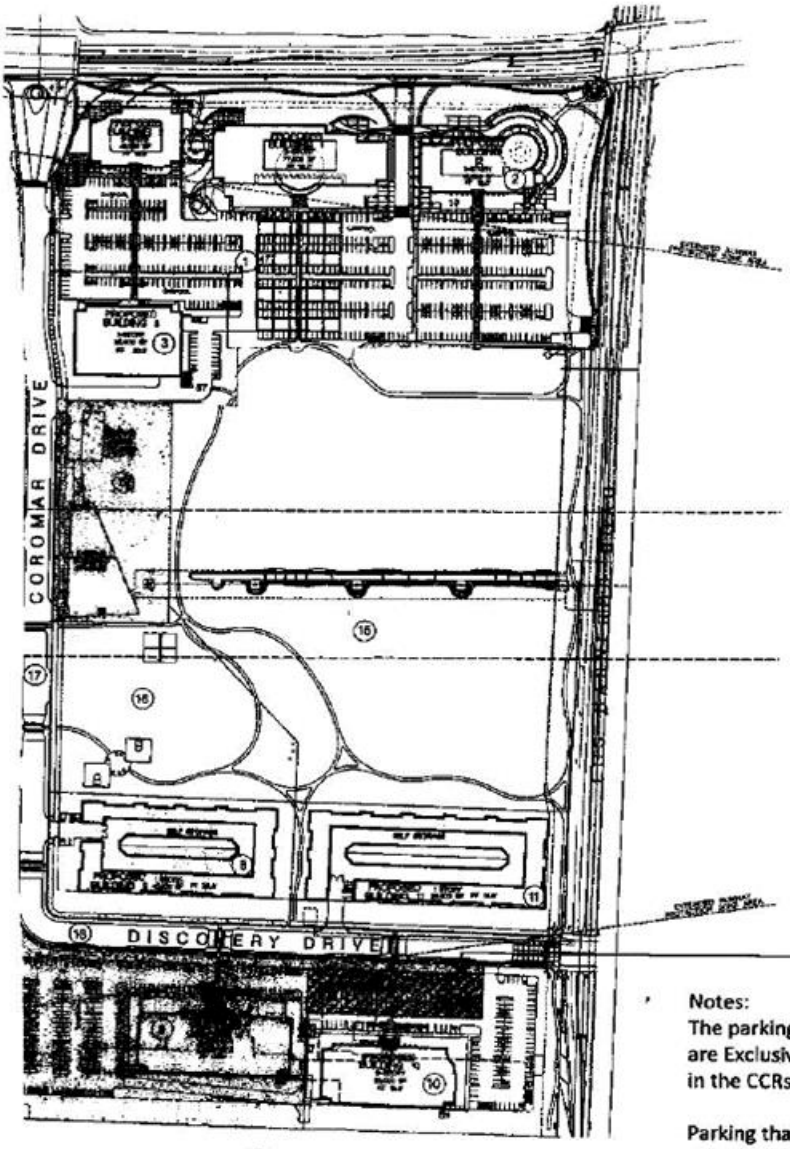
Signer's Name: _____
☐ Individual
☐ Corporate Officer-Title(s): _____
☐ Partner — ☐ Limited ☐ General
☐ Attorney in Fact
☐ Trustee
☐ Guardian or Conservator
☐ Other: _____
Signer is Representing: _____

RIGHT THUMBEPRINT OF SIGNER
Top of thumb here

EXHIBIT "B-2"

Conceptual Site Plan with Parcel Plan Showing
Potential Full Build-Out of the Project
With Parking on Parcel, including Parking provided by Easement





Notes:
The parking on Lots 1, 2, 3, 8,11 and 12 are Exclusive Parking Areas as defined in the CCRs.

Parking that will be committed to other Lots by easement is shown in hatch and cross-hatch patters.

Conceptual Site Plan
Exhibit "B-2"

EXHIBIT "C"

DESCRIPTION OF LOTS; MAXIMUM FLOOR AREAS

"Lot 1" - The land comprising Lot 1 consisting of approximately 9.16 acres of land upon which Declarant contemplates constructing new improvements consisting of two buildings, proposed Building 1 presently contemplated to consist of a two story office building to contain a maximum of 77,000 square feet of Floor Area ("**Building 1**"), proposed Building 2 presently contemplated to consist of a two story office building to contain a maximum of 40,000 square feet of Floor Area ("Building 2"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"Lot 2" - The land comprising Lot 2 consisting of approximately 2.33 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of one building, a proposed office building to contain a maximum of 45,000 square feet of Floor Area ("**Building 12**), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 3" - The land comprising Lot 3 consisting of approximately 2.38 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a warehouse facility to contain a maximum of 30,000 square feet of Floor Area ("**Building 3**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 4" - The land comprising Lot 4 consisting of approximately 3.75 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 60,000 square feet of Floor Area ("**Building 4**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 5" - The land comprising Lot 5 consisting of approximately 5.33 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 40,000 square feet of Floor Area ("**Building 5**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 6" - The land comprising Lot 6 consisting of approximately 3.76 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 40,000 square feet of Floor Area ("**Building 6**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 7" - The land comprising Lot 7 consisting of approximately 4.95 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 80,000 square feet of Floor Area ("**Building 1**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 8" - The land comprising Lot 8 consisting of approximately 2.75 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a one story self storage facility to contain a maximum of 46,100 square feet of Floor Area ("**Building 8**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 9" - The land comprising Lot 9 consisting of approximately 5.97 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 70,000 square feet of Floor Area ("**Building 9**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 10" - The land comprising Lot 10 consisting of approximately 2.92 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 60,000 square feet of Floor Area ("**Building 1**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 11" - The land comprising Lot 11 consisting of approximately 3.13 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a one story self storage facility to contain a maximum of 56,000 square feet of Floor Area ("**Building 11**"), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 12" - The land comprising Lot 12 consisting of approximately 2.32 acres of land upon which is located an approximately 4,007 square foot bond building and existing screened storage area (the "**Lot 12 Improvements**") comprising the maximum Floor Area for Lot 12, as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2**"

"Lot 13" - The land comprising Lot 13 consisting of approximately 4.55 acres of land upon which is located an approximately 47,728 square foot administration building (the "**Lot 13 Administration Building**") comprising the maximum Floor Area for Lot 13, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 14" - The land comprising Lot 14 consisting of approximately 2.96 acres of land upon which is located an approximately 22,000 square foot utility building ("**Building 14**") comprising the maximum Floor Area for Lot 14, and existing screened storage area and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"Lot 15" - of the Project presently contains the land comprising Lot 15 consisting of approximately 15.31 acres of land which is to constitute green belt, buffer area within the Project (the "**Open Space**") as depicted on the Conceptual Site Plan attached hereto as**Exhibit "B-2"**.

"Lot 16" - of the Project presently contains the land comprising Lot 16 consisting of approximately 3.33 acres of land which is to constitute recreational area within the Project (the "**Recreation Area**") as depicted on the Conceptual Site Plan attached hereto as**Exhibit "B-2"**.

"Lot 17" - of the Project presently contains the land comprising Lot 17 consisting of approximately 2.35 acres of land which shall comprise an interior private street or streets or portions thereof within the Project as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"Lot 18" - of the Project presently contains the land comprising Lot 18 consisting of approximately 1.96 acres of land which shall comprise an interior private street or streets or portions thereof within the Project as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"Lot 19" - of the Project presently contains the land comprising Lot 19 consisting of approximately 1.58 acres of land on which Declarant plans to build an approximately 50,000 square foot building as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"Lot 20" - The land comprising Lot 20 consisting of approximately 6.87 acres of land upon which is located an approximately 113,330 square foot manufacturing building ("Building 20") comprising the maximum Floor Area for Lot 20, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"Lot 21" - The land comprising Lot 21 consisting of approximately 1.49 acres of land upon which is located an approximately 9,141 square foot design building ("**Building 21**") comprising the maximum Floor Area for Lot 21, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"Lot 22" - The land comprising Lot 22 consisting of approximately 3.29 acres of land upon which is located an approximately 45,476 square foot program building ("**Building 22**") comprising the maximum Floor Area for Lot 22, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

EXHIBIT "D"

Schedule of Deemed Land Area, Allocated Common Parking Spaces And Common Area Maintenance Percentages

Lot	Building	Maximum Building Square Footage**	Deemed Land Area*	Allocated Parking Spaces**	Parking Ratio - Per 1,000 sq. ft. of Improvements*	Common Expenses Percentage Based on Deemed Land Area:
	New Construction					
1	Building 1 & 2	117,000 sf	7.37 acres	358	3.06	10.7%
2	Building 12	45,000 sf	4.41 acres	138	3.06	6.4%
3	Building 3	30,000 sf	2.01 acres	57	1.90	2.9%
4	Building 4	60,000 sf	3.74 acres	180	3.02	5.5%
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6	Building 5b	40,000 sf	2.62 acres	125	3.12	3.8%
19	Building 6	50,000 sf	3.99 acres	150	3.00	5.8%
7	Building 7	80,000 sf	5.59 acres	247	3.09	8.2%
8	Building 8	46,100 sf	2.79 acres	6	0.13	4.1%
9	Building 9	70,000 sf	4.65 acres	208	2.97	6.8%
10	Building 10	60,000 sf	3.94 acres	182	3.03	5.7%
11	Building 11	55,000 sf	3.11 acres	3	0.05	4.5%
	Existing Buildings					
12	Bond Building	4,000 sf	2.32 acres	N/A	N/A	3.4%
13	Building 13	47,700 sf	4.27 acres	161	3.37	6.2%
14	Building 14	22,000 sf	2.94 acres	71	3.22	4.3%
20	Building 20	113,300 sf	7.18 acres	337	2.97	10.5%
21	Building 21	9,100 sf	1.51 acres	31	3.44	2.2%
22	Building 22	45,500 sf	3.19 acres	142	3.12	4.6%
	Subtotal		**68.62 net acres**			
15, 16, 17 & 18	Common Area Lots		22.72 acres			
	Dedications		0.91 acres			
	Total	**936,000 sf**	**92.25 acres**	**2519 spaces**	**2.69 avg.**	**100%**

* Based upon actual Building Lot acreage, (as set forth on Exhibit "C"). ***plus*** the area of additional land, if any, which is attributable to parking areas allocated for use by the Owner, Occupants and Permittees of such Building Lot by easement from another Building Lot in the Project, and ***less*** the land area, if any, which is located upon such Building Lot and which is allocated by easement for parking use by the Owners, Occupants and Permittees of another Building Lot in the Project

** Based upon permitted/intended use as indicated in the Development Agreement

850722.05/OC

88888-154/2-2-09/dww/dww

2009-0023212

	Recorded	REC FEE	284.00
	Official Records		
	County of		
	Santa Barbara		
	Joseph E. Holland		
RECORDING REQUESTED BY		LC	
AND WHEN RECORDED MAIL TO:	02:27PM 27-Apr-2009	Page 1 of 93	

SARES Regis Group
500 Esplanade, Suite 470
Oxnard, CA 93030
Attention: Cabrillo Business Park Manager

(Space Above For Recorder's Use)

Declaration of
Covenants, Conditions And Restrictions
And Grant And Reservation Of Easements
For Cabrillo Business Park

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DECLARATION OF
COVENANTS, CONDITIONS AND RESTRICTIONS
AND GRANT AND RESERVATION OF EASEMENTS FOR
CABRILLO BUSINESS PARK

This DECLARATION OF COVENANTS, CONDITIONS AND RESTRICTIONS AND GRANT AND RESERVATION OF EASEMENTS FOR CABRILLO BUSINESS PARK is made as of February _, 2009, by SANTA BARBARA REALTY HOLDING COMPANY, LLC, a Delaware limited liability company **("Declarant")** with reference to the following:

R E C I T A L S :

A. Declarant is the owner of certain real property located in the City of Goleta **("City")**, County of Santa Barbara **("County")**, State of California, consisting of approximately 92.25 acres of land and improvements commonly known as "Cabrillo Business Park" and more particularly described on **Exhibit "A"** attached hereto (herein, the **"Property").**

B. Declarant intends to subdivide the Property into as many as twenty two (22) or more (subject to approval by the City) legal lots substantially as shown on Vesting Tentative Tract Map No. 37-SB-TM (the "**Tentative Map**"), presently designated and referred to on the Tentative Map and herein as Lots 1 through 22. Each of Lots 1 through 22 and any further or other subdivision of the Property or such Lots into additional or different legal lots are referred to individually as a "**Lot**" and any two or more Lots and all Lots comprising the Property from time to time may be referred to herein collectively as "**Lots**". Declarant may accomplish such subdivisions in phases by recording final maps based on the Tentative Map as to one or more of such Lots. Declarant intends that the provisions of this Declaration be restrictive covenants made pursuant to §1468 of the California Civil Code, and that this Declaration will inure to the mutual benefit of and be binding upon each of the Lots within the Project, as well as the Declarant and the respective successor Owners (as hereinafter defined) of each of the Lots in the Project during their respective periods of ownership.

C. Declarant intends to develop and operate the Property as a commercial common interest development described in §1351(k) of the California Civil Code as a "Planned Development" and to sell, lease or otherwise convey portions of the Property to various individuals or entities for purposes compatible with such development and operation. The Property, together with all Improvements (as hereinafter defined) now or hereafter constructed upon the Property is referred to herein as the **"Project"**. A site plan showing the Project in its current state of development and reflecting the existing legal Lots comprising the Property as of January 1, 2009 is attached hereto as attached hereto as **Exhibit "B-1"** (the **"Current Site Plan"**) and a conceptual site plan showing the Project at projected complete build-out with all Lots presently contemplated for the Project is attached hereto as **Exhibit "B-2"** (the **"Conceptual Site Plan"**).

D. By this Declaration, Declarant intends to impose upon the Property mutually beneficial restrictions, in accordance with a general plan of improvement, in order to establish and provide a means of maintaining a high quality environment for the benefit of Declarant and all future owners and occupants of the Property and any and all portions thereof.

E. Terms which are capitalized in this Declaration and are not defined in the body of this Declaration appearing in Articles 1 through 26 are defined in the Definitions contained in Article 27.

NOW, THEREFORE, Declarant hereby declares that the Property and each portion thereof is and shall be held, owned, conveyed, sold, mortgaged, encumbered, leased, developed, improved, used and occupied subject to this Declaration and the limitations, covenants, conditions, restrictions, easements, liens and charges set forth herein, all of which are equitable servitudes and shall run with the title to the Property and shall be binding on and inure to the benefit of all parties having or acquiring any right, title or interest in the Property or any portion thereof, and their respective heirs, successors and assigns. The purpose of this Declaration is to enhance and protect, and provide a means of controlling and maintaining, the value, desirability and attractiveness of the Property and every portion thereof, for the benefit of Declarant and every owner, in accordance with a general plan of subdivision, development and improvement.

ARTICLE 1
ASSOCIATION: MEMBERSHIP AND VOTING RIGHTS IN ASSOCIATION

1.1 Organization of Association. It is intended that California Civil Code Section 1350et seq. (the "**Act**") apply to this Declaration and to the Project to the extent required by law. To the extent the Act is applicable to the Project, the Project shall be a planned development type of common interest subdivision. Declarant, in its good faith yet absolute judgment shall determine if the Act applies. In addition, Declarant may either elect to (i) form the Association and comply with the terms of the Act notwithstanding that the Act may or does not apply to the Project, or (ii) to the extent the Act may be validly waived, waive the Act, in whole or in part, as it may apply to the Project. At any time after the date of this Declaration, Declarant may cause the Association to be formed and take such steps as may be necessary or appropriate in connection with such formation including, subject to all the provisions of this Section 1.1, the preparation, execution, and filing of the Articles and Bylaws of the Association and the making of all other appropriate filings for the following purposes: (i) assuming any or all of the rights and obligations of Declarant and Operator under this Declaration; and/or (ii) exercising any or all of the duties and powers of Declarant and Operator, in the Articles and the Bylaws (hereafter, this Declaration, the Articles and the Bylaws may sometimes be referred to collectively as the **"Governing Documents"**). The Association, when formed, shall be incorporated under the name of CABRILLO BUSINESS PARK OWNERS ASSOCIATION, as a corporation not for profit under the Nonprofit Mutual Benefit Corporation Law of the State of California, as required by Section 1363 of the California Civil Code. All costs of formation and operation of the Association shall be Common Expenses.

1.2 Duties and Powers. The duties and powers of the Association are those set forth in this Declaration and in the Articles and Bylaws, together with its general and implied powers of a nonprofit corporation, generally to do any and all things that a corporation organized under the Laws of the State of California may lawfully do which are necessary or proper, in operating for the peace, health, comfort, safety and general welfare of its Members, subject only to the limitations upon the exercise of such powers as are expressly set forth in the Articles, the Bylaws and in this Declaration. The Association shall make available for inspection by any prospective purchaser of a Lot, any Owner of a Lot, and the Beneficiaries, insurers and guarantors of the first Mortgage on any Lot, current copies of the Declaration, the Articles of Incorporation, the Bylaws, the Rules and Regulations and all other books, records, and financial statements of the Association.

1.3 Membership. Every Owner of a Lot which is subject to assessment by the Association (even if assessments have not yet commenced with respect to such Lot) shall be a Member of the Association. Membership shall be appurtenant to ownership of any Lot subject to assessment, and membership shall not be separated from such ownership or transferred, pledged or alienated in any way, except that an Owner, upon giving written notice to the Association, may, at its option, grant to an Occupant which satisfies the requirements of an Owner under the definition of Owner in Article 27, a power coupled with an interest to act as the Owner's agent in all matters relating to the Association; any such power shall automatically terminate upon expiration of such Occupant's lease or the earlier termination of such Occupant's tenancy for any reason. Any attempt to transfer a membership in violation of this Section shall be void and shall not be reflected in the books and records of the Association.

1.4 Transfer. The Association membership held by any Owner of a Lot shall not be transferred, pledged or alienated in any way, except upon the sale or encumbrance of such Owner's Lot, and then only to the purchaser or Mortgagee of such Lot. Any attempt to make a prohibited transfer is void, and will not be reflected upon the books and records of the Association. A Class A Member (as defined below) who has sold such Member's Lot to a contract purchaser under an agreement to purchase shall be entitled to delegate to such contract purchaser his membership rights in the Association. Such delegation shall be in writing and shall be delivered to the Board before such contract purchaser may vote. The contract seller shall be liable for all charges and assessments which are assessed against his Lot up to the date on which fee title to the Lot sold is transferred. If the Owner of any Lot should fail or refuse to transfer the membership registered in his name to the purchaser of such Lot upon transfer of fee title thereto, the Board of Directors shall have the right to record the transfer upon the books of the Association. Until satisfactory evidence of such transfer has been presented to the Board, the purchaser shall not be entitled to cast the votes attributable to such Lot at meetings of the Association. The Association may levy a reasonable transfer fee against such purchaser (which fee shall be added to the Annual Assessment chargeable to such new Owner) to reimburse the Association for the administrative cost of transferring the membership to the new Owner on the records of the Association.

1.5 Voting Rights. The Association shall have two (2) classes of voting membership as follows:

Class A. Class A Members shall be all Owners of Building Lots. Each Class A Member shall from time to time be entitled (with respect to each Building Lot owned by such Member) to cast two (2) votes for each 1,000 square feet of Maximum Floor Area which is allocable to such Owner's Lot.

When more than one Person holds an interest in any Building Lot, all such Persons shall be Members. The vote for such Building Lot shall be exercised in accordance with Section 1.6 below.

Class B. The Class B Member shall be Declarant and/or its Affiliate if Declarant transfers any Lot to such Affiliate, so long as Declarant and/or Declarant's Affiliate owns any interest in a Lot or until Class B membership ceases. The Class B Member shall be entitled to cast 10,000 votes. If the Class B membership is comprised of more than one member, all decisions of the Class B membership under this Declaration shall require unanimous consent of the Class B members. The Class B membership shall cease when Declarant and its Affiliates, no longer own any interest (including but not limited to any security interest) in Lots or upon the earlier recording of an amendment to this Declaration, executed solely by Declarant, and/or its Affiliate if Declarant transfers any Lot to such Affiliate, stating that the Class B membership has ceased. If an affiliated entity succeeds to the Declarant's or its Affiliate's ownership interest in all or any portion of the Project, then such entity shall succeed to the Class B member voting rights of Declarant as it pertains to the portion of the Project owned by the entity.

1.6 Vote Distribution. All voting rights shall be subject to the restrictions and limitations provided in this Declaration and in the Articles and Bylaws. When more than one Person holds an interest or interests in any Lot (**"Co-Owner"**), all such Co-Owners shall be Members and may attend any meetings of the Association, but only one such Co-Owner shall be entitled to exercise the votes to which the Lot is entitled. Such Co-Owners may from time to time all designate in writing one of their number to vote. Fractional votes shall not be allowed, and the Class A votes for each Lot shall be exercised, if at all, as a unit. Where no voting Co-Owner is designated or if such designation has been revoked, the votes for such Lot shall be exercised as the majority of the Co-Owners of the Lot mutually agree. Unless the Board receives a written objection from a Co-Owner, it shall be presumed that the corresponding voting Co-Owner is acting with the consent of his or her Co-Owners. No votes shall be cast for any Lot where the Co-Owners present in person or by proxy owning the majority interests in such Lot cannot agree to said votes or other action. The nonvoting Co-Owner or Co-Owners shall be jointly and severally responsible for all of the obligations imposed upon the jointly owned Lot and shall be entitled to all other benefits of ownership. All agreements and determinations lawfully made by the Association in accordance with the voting percentages established herein, or in the Bylaws, shall be deemed to be binding on all Owners, their successors and assigns.

1.7 Powers. The Association shall have the following powers, rights and duties, in addition to those provided elsewhere in this Declaration, the Articles and the Bylaws and those powers granted to a nonprofit mutual benefit corporation pursuant to the California Corporations Code:

(a) Acquisition of Property. The Association shall have the power to acquire (by gift, purchase or otherwise), own, hold, improve, operate, maintain, convey, sell, lease, transfer, dedicate for public use or otherwise dispose of real or personal property, including, without limitation, all Common Area Lots within the Project, in connection with the affairs of the Association.

(b) Assessments, Liens. The Association, acting as Operator through its Board, shall have the power to levy and collect assessments pursuant to Article 2 and to perfect and enforce liens in accordance with the provisions of Article 2.

(c) Contracts. The Association, acting as Operator through its Board, shall have the power to contract for goods and/or services for the Common Areas or for the performance of any power or duty of the Operator under this Declaration, subject to limitations set forth elsewhere in this Declaration, the Articles or the Bylaws. The Association's power to contract shall include, but is not limited to, the right to enter into agreements with one or more other owners' associations for the purposes described in this Section.

(d) Delegation. The Association shall have the power to delegate its authority and powers to committees, officers or employees of the Association.

(e) Enforcement. The Association, as Operator through its Board, shall have the power to enforce this Declaration pursuant to the provisions hereof.

(f) Security Services. The Association, acting as Operator through its Board, shall have the power to provide, or to contract for the provision of, security patrols or other security measures, or both, as the Board deems necessary.

(g) Water Service. The Association, acting as Operator through its Board, shall have the power to contract with the GWD to retain and obtain water service to the Project at the point of the two (2) existing main water meters which serve the Project. The Association, acting as Operator through its Board, shall have the power to administer the distribution of water service obtained by the Association from GWD throughout the Project through such Common Water Lines and Private Water Lines as the Association may deem necessary and appropriate for the further development and operation of the Project, which shall include without limitation the power to install, maintain, repair and replace Common Water Lines and Private Water Lines within the Project. The Association, acting as Operator through its Board, shall have the power to assess Regular Assessments against all Owners in the Project for Common Water Costs for water service provided by the Operator through Common Water Lines in the Project and the power to assess Special Assessments to each Owner for Private Water Costs for water service provided by the Operator to such Owner's Lot and such Owner's Buildings situated on such Owner's Lot through Private Water Lines.

(h) **Variances.** The Association, acting as Operator through its Board, shall have the power to grant reasonable variances from the provisions of this Declaration from time to time, as the Board may deem, in its sole discretion, to be in the best interests of the Project, in order to overcome practical difficulties and to prevent unnecessary hardship in the application of the provisions contained herein; provided, however, that: (a) a variance shall not materially affect any of the Lots or Improvements in the Project; and (b) the Owner seeking the variance shall otherwise be subject to and conform with all applicable Laws and requirements. No variance granted pursuant to the authority granted herein shall constitute a waiver of any provision of this Declaration as applied to any person or real property.

1.8 **Initial Board of Directors.** The initial Board of Directors of the Association shall consist of three (3) directors appointed by Declarant upon the incorporation of the Association and shall hold office until the initial Board calls the first annual meeting of Members pursuant to Section 1.11 below.

1.9 **Subsequent Board of Directors.** At the first annual meeting of Members, the initial Board of Directors shall be ratified and confirmed to serve until the next annual meeting or a new Board consisting of three directors shall be elected, and such Board shall serve until the next annual meeting. At each subsequent annual meeting of Members, a new Board consisting of three directors shall be elected, and such Board shall serve until the next annual meeting. The Bylaws may provide for staggered terms and lengths of terms for directors different from those initially set forth in this Declaration and may provide for a greater or lesser number of directors than set forth herein; provided, however, in no event shall there be more than seven (7) directors or less than three (3) directors. The Board shall undertake all duties and responsibilities of the Association and the management and conduct of the affairs thereof, except as expressly reserved herein to a vote of the Members.

1.10 **Personal Liability.** No member of the Board, or of any committee of the Association, or any officer or manager of the Association shall be personally liable to any Owner, or to any other party, including the Association, for any damage, loss or prejudice suffered or claimed on account of any act, omission, error or negligence of any such Person.

1.11 **Annual Membership Meetings.** The initial Board may call the first annual meeting of Members at any time after the Association has been formed. Thereafter, the Association shall hold an annual meeting of the Members in accordance with the Bylaws of the Association.

1.12 **Pre-Association Powers of Declarant.** For purposes of this Article 1, the Association shall not be deemed formed until it is incorporated and the Board has been appointed or elected. Until such time as the Association has been formed, Declarant shall be entitled to exercise all rights and powers the Association would have when formed, as provided in this Declaration, and of an association formed in accordance with the requirements of the Act, including, but not limited to, the right to levy and enforce the payment of Assessments pursuant to the terms of the Act.

ARTICLE 2
COVENANT FOR PAYMENT OF ASSESSMENTS

2.1 **Creation of Lien and Personal Obligation for Assessments.** Each Owner, for each Lot owned which is subject to assessment hereunder, hereby covenants and agrees, and by acceptance of a deed therefor, whether or not it shall be expressed in such deed, is deemed to covenant and agree to pay to the Operator: (a) annual Regular Assessments described in Section 2.5 for the periodic maintenance, repair and replacement of all Common Areas and for the reimbursement of the Operator for all manner of Common Expenses incurred by the Operator including, without limitation, for Common Water Costs; (b) Special Assessments described in Section 2.6, including, without limitation, for Private Water Costs; (c) Reimbursement Assessments described in Section 2.7; and (d) such other assessments which the Operator is authorized to levy pursuant to this Declaration, such assessments to be established and collected as provided in this Declaration. Assessments, together with interest pursuant to Section 2.8, reasonable collection costs and attorneys' fees, shall (except as otherwise provided in Section 2.10) be a charge on the Lot and shall be a continuing lien upon the Lot against which each such assessment is made, the lien to be effective upon recordation of a notice of delinquent assessment. Each such assessment, together with interest pursuant to Section 2.8, reasonable collection costs and attorneys' fees, shall also be the personal obligation of the Person who was the Owner of such Lot at the time the assessment fell due. If more than one Person is the Owner of a Lot subject to assessment, the personal obligation to pay such assessment shall be joint and several. The personal obligation for delinquent assessments shall not pass to an Owner's successors in title, however, unless expressly assumed by them, but any lien established hereunder shall remain a charge against the Lot except as set forth in Section 2.12.

2.2 Purpose of Assessments. The assessments levied by the Operator shall be used exclusively to pay Common Expenses and Common Parking Expenses (as defined in Article 27), to reimburse the Operator for the costs incurred in bringing an Owner into compliance with the Project Documents and only for such other purposes as are expressly set forth in this Declaration.

2.3 Budgets. At least thirty (30) days prior to the date for commencement of Regular Assessments pursuant to Section 2.5, and at least thirty (30) days prior to the commencement of each calendar year thereafter, the Operator shall prepare or cause to be prepared and shall distribute to all Owners a pro forma operating budget ("Budget") for such first or successive calendar year setting forth the estimated revenue and expenses on an accrual basis. The Budget shall include a reasonable allowance for contingencies, replacements and reserves. Until the first organizational meeting of the Association is held, Declarant shall have full authority to establish and determine the amount of Regular Assessments. Thereafter, Regular Assessments shall be determined by the Association through its Board as provided herein. Once the Association has been formed, the Operator shall deliver, together with each annual Budget: (a) notice of the Members' right to obtain copies of minutes of Board meetings, to the extent required under California CIVIL CODE Section 1363; and (b) the summary of the provisions of California CIVIL CODE Section 1354, as required by such Section.

2.4 Lots Subject to Assessment; Allocation of Assessments. Except as provided below, all Lots within the Project are subject to Regular Assessments and to Special Assessments.

(a) Lots 3, 8, 11 and 12 and other Exclusive Use Area Expenses. All Exclusive Use Area Expenses shall be paid directly by the Owner(s) entitled to the use and benefit of such Exclusive Use Area(s), but to the extent any such Exclusive Use Area Expenses are administered and incurred by the Operator they shall be assessed by the Operator to the Owner(s) entitled to the use and benefit of such Exclusive Use Area(s) as a Regular Assessment To the extent any such Exclusive Use Area(s) is (are) shared by more than one Owner as reasonably determined by the Operator, the Owners entitled to the use and benefit of such Exclusive Use Area(s) shall share all Exclusive Use Expenses attributable to such Exclusive Use Area(s) on an equitable basis based upon the respective usage of or benefits derived from such Exclusive Use Area and Exclusive Use Area Improvements as determined by the Operator or by mutual agreement of such Owners. Without limiting the foregoing, and by way of example, all costs and expenses incurred by the Operator and not directly paid for by the Owners or Occupants of Lots 3, 8, 11 or 12, respectively, for their Exclusive Parking Areas, shall be assessed solely to the Owner(s) of such Lots, as applicable, as Exclusive Use Area Expenses of such Owner(s), respectively.

(b) Common Expenses. Except as otherwise provided in this Declaration, including, without limitation, as to assessments pertaining to Exclusive Use Area Expenses, certain Common Expenses attributable to Common Utility Lines, including Common Water Lines, and Common Parking Expenses, and except for Reimbursement Assessments described in Section 2.7, all Regular Assessments and Special Assessments shall be allocated pro rata among all Building Lot Owners entitled to use the Common Areas in question, with each Building Lot Owner's share to be a fraction, the numerator of which shall be the "Deemed Area of Land" for each such Owner's Building Lot, and the denominator of which shall be the sum of the various numerators for all Owners of Building Lots entitled to use such Common Areas (which shall specifically exclude the acreage of the Common Area Lots and all public dedications). The Deemed Area of Land for each Building Lot for all purposes of this Declaration shall mean the actual acreage of the Building Lot in question (as set forth on Exhibit "C"), ***plus*** the area of additional land, if any, which is attributable to parking areas allocated for use by the Owner, Occupants and Permittees of such Building Lot by easement from another Building Lot in the Project, and ***less*** the land area, if any, which is located upon such Building Lot and which is allocated by easement for parking use by the Owners, Occupants and Permittees of another Building Lot in the Project. Exhibit "D" attached hereto sets forth, among other things, the Deemed Area of Land allocated to each Building Lot as of the date of recordation of this Declaration which is based upon the pending amended development plan for the Project. The Deemed Area of Land for each Building Lot shall be adjusted to reflect any changes to the amended development plan for the Project once approved by the City and recorded.

(c) Common Parking Expenses. Regular Assessments and Special Assessments for Common Parking Expenses (including Real Property Taxes and insurance attributable to Common Parking Areas) shall be allocated pro rata among all Building Lot Owners entitled to use the Common Parking Areas in question, with each Owner's share to be a fraction, the numerator of which shall be the total number of Allocated Parking Spaces within such Common Parking Areas which are allocated to the Building Lot(s) owned by such Owner and the denominator of which shall be the sum of the various numerators of all such Allocated Parking Spaces for all Owners of Building Lots entitled to use such Common Parking Areas. The Allocated Parking Spaces for each Building Lot are set forth on Exhibit "D" attached hereto. Regular Assessments and Special Assessments for Common Parking Areas shall commence with respect to each Building Lot upon the later of completion of the Common Parking Improvements required to serve such Building Lot or issuance of a certificate of occupancy or other equivalent authorization for occupancy for the Building constructed upon such Building Lot.

(d) **Trash Removal.** The cost of Common Area trash and rubbish removal, if any, shall be allocated pro rata as equitably determined by the Operator among all Owners who share in such trash removal services, based upon Floor Area of all constructed Buildings of all such Owners sharing in such trash removal services. Trash and rubbish removal for each Building shall be coordinated and paid individually by the Owners of such Buildings as Exclusive Use Area Expenses. Regular Assessments and Special Assessments for Common trash removal services shall commence with respect to each Building Lot upon the issuance of a certificate of occupancy or other equivalent authorization for occupancy for the Building constructed upon such Building Lot.

(e) **Common Utility Expenses and Common Water Costs** Common Expenses attributable to Common Utility Lines, including Common Water Lines, which, in the Operator's reasonable judgment, are fairly allocable to the servicing of Common Areas and Common Area Improvements shall be allocated pro rata among all Building Lot Owners entitled to use the Common Utility Lines and Common Water Lines in question, with each Building Lot Owner's share to be a fraction, the numerator of which shall be the Floor Area of all Buildings actually constructed upon such Owner's Building Lot, and the denominator of which shall be the sum of the various numerators for all Owners of Buildings entitled to use such Common Areas and Common Area Improvements. The remaining cost of maintaining, repairing and replacing Common Utility Lines, including Common Water Lines, shall be allocated directly to and paid by the Owner or Owners whose Building(s) is (are) served by such Common Utility Lines or Common Water Lines, or, if more than one Owner, to such user Owners in such proportion as is set forth in a separate recorded agreement executed by such Owners and furnished to the Operator or pursuant to the Operator's measurement of metered usage by such Owners or such utilities or water. If there are two (2) or more user Owners, then unless and until the Operator is provided with such a separate agreement, or installs separate metering devices to measure usage by such Owners, the Operator shall allocate the cost of the Common Utility Lines or Common Water Lines on an equitable basis among all of the benefited Owners as reasonably determined by the Operator. By way of illustration, pursuant to such pro rata allocation, if two (2) Buildings were serviced by one Common Utility Line or Common Water Line, each such Building Lot Owner would be responsible for one-half (1/2) of the cost thereof. Regular Assessments and Special Assessments for Common Utility Expenses shall commence upon the recordation of the Final Map which contains such Building Lot.

(f) **Real Property Taxes.** Real Property Taxes attributable to Common Area Lots (which shall be distinguished from Real Property Taxes attributable to Common Areas situated upon Building Lots) shall be allocated pro rata among all Owners of Building Lots, with each Building Lot Owner's share to be a fraction, the numerator of which shall be the Deemed Area of Land for each such Owner's Building Lot, and the denominator of which shall be the sum of the various numerators for all Owners of Building Lots entitled to use such Common Areas (which shall specifically exclude the acreage of the Common Area Lots and all public dedications, it being intended that the property value, if any, of any Common Area Lots and areas of public dedication be allocated by the taxing authority ratably as part of the property value of all Building Lots within the Project). Real Property Taxes attributable to Common Area Lots shall consist of all Real Property Taxes attributable to land and Improvements located upon the Property exclusive of Real Property Taxes attributable to (i) Building Lots and all Improvements located thereon; and (ii) any undeveloped portion of the Property until such time as Declarant or its successor has designated such undeveloped portion as a "Common Area Lot" and such property has been improved with Common Area Improvements and a certificate of occupancy or other governmental approval authorizing use of such Common Area Improvements has been issued. Real Property Taxes attributable to Common Parking Areas shall be allocated and paid as provided in Section 2.4(c) above. Regular Assessments and Special Assessments for Real Property Taxes attributable to Common Area Lots shall commence with respect to each Building Lot upon the recordation of the Final Map which contains such Building Lot.

(g) **Building Lot Real Property Taxes, Repairs and Insurance**. The payment of Real Property Taxes attributable to any Building Lot and all Improvements thereon (including, without limitation, Common Area Improvements thereon, if any, and Real Property Taxes for Common Area Lots which have been allocated to such Building Lot as provided herein), costs of repairs and maintenance and all insurance premiums for policies covering the same shall be paid directly by the Owner of such Building Lot as provided in this Declaration.

2.5 **Regular Assessments.**

(a) **Purpose.** Regular Assessments shall be used only to defray Common Expenses including Common Parking Expenses and Common Water Costs.

(b) **Date of Commencement of Regular Assessments; Due Dates.** Regular Assessments for all existing Buildings located upon Building Lots shall commence as of the recordation of this Declaration. The Owner(s) of any undeveloped Building Lots shall pay all costs and expenses for maintenance and repair of such undeveloped Building Lots without contribution from any other Owners and shall pay all Common Expenses, Real Property Taxes, utility costs, if any, and insurance costs attributable to such undeveloped Building Lots (including the prorata share of Common Area Lot Real Property Taxes which are allocated to such Building Lots), commencing upon recordation of the Final Map which contains such Building Lot, but such Building Lot Owners shall not pay any Regular Assessments for Common Parking Expenses or Common Area trash removal until the applicable commencement of such Assessments for such Owner as provided in Sections 2.4(c) or (d) above. Once a certificate of occupancy or other equivalent authorization for occupancy shall be issued for a new Building upon a Building Lot and all required Exclusive Parking Areas or Common Parking Areas for such Building have been completed, the Owner of the Building Lot upon which such Building has been constructed shall become obligated to pay to the Operator such Owner's pro rata share of all Regular Assessments and other Assessments payable pursuant to this Declaration including Assessments for Common Parking Expenses and Common Area trash removal, as applicable in accordance with the applicable pro rata share allocation as provided in this Article 2. The first Regular Assessments shall be adjusted according to the number of months remaining in the calendar year in which such assessments commence and shall be prorated for any partial month (on the basis of a 30-day month). The Operator shall fix the amount of the Regular Assessment against each Lot at least thirty (30) days in advance of each Regular Assessment period and shall provide written notice of such Regular Assessments to every Owner of a Lot subject thereto.

(c) **Failure to Fix Regular Assessments.** The omission by the Operator to fix the Regular Assessments hereunder before the expiration of any calendar year, for the next year, shall not be deemed either a waiver or modification of any provisions of this Declaration or a release of any Owner from the obligation to pay the assessments or any installment thereof for that or any subsequent year, and the Regular Assessment fixed for the preceding year shall continue until new Regular Assessments are fixed.

(d) **Revised Regular Assessment.** If the Operator reasonably determines that the Regular Assessment established for any year is, or will become, insufficient to meet all Common Expenses, it may determine the approximate amount of such deficiency and revise the amount of the Regular Assessments for each Owner for the balance of such year to reduce or avoid the deficiency. After the end of each calendar year, the Operator shall cause an accounting to be made of all Common Expenses for such year and the amount of Regular Assessments and any Special Assessments paid for such year. If the Regular Assessments and any Special Assessments collected exceed the Common Expenses, the Operator may refund the excess to Owners, or apply such excess toward Regular Assessments next becoming due from Owners, in either event in the same proportion as the Regular Assessments were paid.

(e) **Payment of Assessments.** Regular Assessments shall be due and payable by the Owners to the Association in advance in equal monthly installments, on or before the first (1st) day of each month of each calendar year, or in such other manner as the Operator shall designate.

2.6 **Special Assessments.**

(a) **Purpose.** Special Assessments may be levied by the Operator:

(i) If the Operator determines that the Regular Assessments are or will be insufficient to defray actual Common Expenses for a given year due to unanticipated delinquencies or cost increases or as Reconstruction Assessments for unexpected repairs, replacements or reconstruction of any Improvements in those Common Areas maintained by the Operator;

(ii) If funds are otherwise required for any authorized activity of the Operator; or

(iii) As Capital Improvement Assessments, for the purpose of defraying, in whole or in part, the cost of construction of any capital improvements within the Common Areas (excluding Exclusive Use Areas) deemed reasonably necessary by the Operator for the benefit of the Project, provided that any such capital improvement assessment in excess of five percent (5%) of all Regular Assessments budgeted for that calendar year, except for those necessary for compliance with the Americans With Disabilities Act, shall require approval by the vote or written consent of Members holding a majority of the voting power of the Association Members, and the Declarant for so long as Declarant owns any portion of the Project; or

(iv) For Private Water Costs.

(b) Establishment. The Operator shall determine the approximate amount necessary to defray the expenses set forth in Section 2.7(a) which shall be assessed against the Owners as a Special Assessment; provided, however, that the Operator may, in its discretion, prorate such Special Assessment over the remaining months of the calendar year or levy the full assessment immediately against each Lot subject to assessment. Special Assessments may be assessed against an individual Lot or Lots or fewer than all Lots in the Project in the reasonable discretion of the Operator based upon an equitable allocation of the Private Water Costs or Common Expenses comprising such Special Assessments to the Lots which are benefited by such Common Expenses. Any Special Assessment in excess of ten percent (10%) of the budgeted Regular Assessments of the Operator for the calendar year in which a Special Assessment is levied shall require approval by Members holding a majority of the voting power of the Association Members, and the Declarant for so long as Declarant owns any portion of the Project.

(c) Payment of Assessments. Special Assessments shall be due and payable within thirty (30) days after a Member receives written notice from the Operator specifying the amount of the Special Assessment, unless the Operator specifies in such notice a later date for payment, provided in no event shall any Owner be liable for any Special Assessments until its obligation to pay Regular Assessments shall have commenced hereunder.

2.7 Reimbursement Assessment. The Operator may also impose a Reimbursement Assessment against any Owner to reimburse the Operator for costs incurred in bringing the Owner and the Owner's Lot into compliance with the provisions of this Declaration, the Articles, Bylaws and rules and regulations of the Association, if any, which assessment may be imposed by the Operator after notice and an opportunity for a hearing which satisfy the requirements of § 7341 of the California Corporations Code, as set forth in the Bylaws.

2.8 Effect of Non-Payment of Assessments: Remedies of the Operator. Any assessment against an Owner and its Lot made in accordance with this Declaration shall be a debt of the Owner of the Lot from the time the assessment is due. Any assessment not paid within thirty (30) days after the due date shall bear interest from thirty (30) days following the due date at the rate of the greater of (a) twelve percent (12%) per annum, or (b) two percent (2%) per annum over the Prime Rate published in the California Edition of the Wall Street Journal most recently before the due date, or the maximum amount permitted by applicable law. The Operator may bring an action at law against the Owner personally obligated to pay the assessment, and in addition thereto, or in lieu thereof, may foreclose the lien against the Lot.

Any assessment not paid within fifteen (15) days after the due date shall be delinquent. The amount of any such delinquent assessment plus costs of collection, late charges, interest and attorneys' fees, shall be and become a lien upon the Lot when the Operator causes to be recorded in the Office of the County Recorder of Santa Barbara County, California, a Notice of Delinquent Assessment, which shall state the amount of such delinquent assessment and such other charges thereon as may be authorized by this Declaration, a description of the Lot against which the same has been assessed, the name of the record Owner of the Lot and, in order for the lien to be foreclosed by non-judicial foreclosure, the name and address of the trustee authorized by the Operator to enforce the lien by sale. The Notice of Delinquent Assessment shall be signed by the person designated by the Operator for that purpose or, if no one is designated, by Declarant or the President of the Association. Upon payment of the delinquent assessment and charges in connection with which the Notice of Delinquent Assessment has been recorded, or other satisfaction thereof, the Operator shall cause to be recorded a further notice stating the satisfaction and the release of the lien thereof. Such lien may be enforced by sale by the Operator after failure of the Owner to pay such assessment in accordance with its terms, such sale to be conducted in accordance with the provisions of §2924, §2924b and §2924c of the California Civil Code applicable to the exercise of powers of sale in mortgages or in any other manner permitted by law. The Operator shall have the power to purchase the Lot at the foreclosure sale and to hold, lease, mortgage and convey the same. Suit to recover a money judgment for unpaid assessments, interest and attorney’s fees may be commenced and maintained without foreclosing or waiving the lien securing the same. Any sale or transfer of any Lot pursuant to this Section 2.8 shall not disturb the possession, or otherwise diminish the rights or enlarge the obligations, of any Occupant under any then-existing lease.

2.9 Right of Owner to Audit Books and Records of Operator. Each year, each Owner shall have the right, exercisable by delivering ten (10) days advance written notice to the Operator, to have conducted, at such Owner's cost and expense, one (1) audit of the Operator's books and records pertaining to the operation of the Project. Any such audit may encompass any or all of the three (3) previous years of the operation of the Project; provided, however, any Owner shall be entitled to audit any given year only once. If any such audit discloses any error in the determination of the proportionate share of Regular Assessments of any Owner or in the composition of any cost comprising the Regular Assessments: (a) an appropriate adjustment shall be made promptly between the Owner(s) and the Operator to correct the error; and (b) if the error is greater than ten percent (10%) of the auditing Owner’s actual proportionate share of the Regular Assessments, then the Operator shall reimburse the auditing Owner for the reasonable auditor's fees and costs incurred by the auditing Owner in having the audit performed.

2.10 Subordination of the Lien to Mortgages. The lien of any assessment levied upon a Lot pursuant to this Declaration shall be subordinate and subject to the lien of any Mortgage now or hereafter placed upon such Lot, which has been made in good faith and for value and recorded prior to the recordation of any such assessed lien, and the sale or transfer of such Lot pursuant to judicial or nonjudicial foreclosure of a prior Mortgage shall extinguish the lien of such assessments as to payments which became due prior to such sale or transfer; provided, however, that Owner shall continue to remain personally liable for the assessment. No sale or transfer shall relieve such Lot from lien rights for any assessments thereafter becoming due. Where the Mortgagee of a prior Mortgage or other purchaser of a Lot obtains title to the same as a result of foreclosure, such acquirer of title, its successors and assigns, shall not be liable for the share of assessments chargeable to such Lot which became due prior to the acquisition of title to such Lot by such acquirer.

2.11 Estoppel Certificate. The Operator shall furnish or cause an appropriate officer to furnish, within ten (10) days of a written demand by any person, a certificate signed by an officer of the Operator setting forth whether the assessments on a specified Lot have been paid. A properly signed certificate of the Operator with respect to the status of assessments on a Lot is binding upon the Operator as of the date of its issuance.

2.12 Personal Liability of Owner. No Owner may exempt itself from personal liability for assessments, nor any part thereof, levied by the Operator, nor release the Lot it owns from the liens and charges of assessments pursuant to this Declaration, by waiving the use and enjoyment of the Common Areas and facilities thereof, or by abandonment of its Lot(s).

2.13 No Offsets. All assessments shall be payable in the amounts specified by that particular assessment, and no offsets against such amount shall be permitted for any reasons, including, without limitation, a claim that the Operator is not properly exercising its duties of maintenance, operation or enforcement.

2.14 Transfer of Property. After transfer of any Lot within the Project, the transferring Owner shall not be liable for any assessment levied on such Owner's prior Lot after the date such Lot is transferred and written notice of such transfer is delivered to the Operator. The transferring Owner shall remain responsible for all assessments and charges levied on its Lot prior to any such transfer.

ARTICLE 3
ARCHITECTURAL AND DEVELOPMENT REVIEW COMMITTEE

3.1 General Control over Property. Declarant shall initially exercise all of the rights and powers of the Committee set forth in this Declaration (including, without limitation, under Article 6 hereof), unless and until any or all of such rights and powers are assigned by Declarant as provided in this Declaration. After formation of the Association, when Declarant's rights are assigned by Declarant to the Committee as provided in this Declaration, any consent or approval previously given by Declarant in the exercise of such rights and powers shall be binding upon the Committee and all Owners. Declarant and Committee shall follow the basic procedures for granting or denying approvals, as set forth in this Article 3, unless otherwise provided in a Supplemental Declaration (as defined in Article 14), a deed or lease of a Lot reflecting a conveyance from Declarant. Whenever this Declaration requires any matter to be approved by the Committee, such matter shall require approval by Declarant (in lieu of approval by the Committee) until such rights and powers are assigned by Declarant to the Committee pursuant to this Declaration. After such rights and powers have been so assigned to the Committee, the Committee's approval of such matters shall be required as set forth in this Declaration. Notwithstanding anything to the contrary contained in this Article 3, all Improvements within the Project shall be subject to review by the City of Goleta Design Review Board (the **"City Design Review Board"**) and any approvals granted by the Committee shall not be construed as approval by the City Design Review Board, nor shall approvals granted by the Design Review Board constitute approval by the Committee.

3.2 Assignment of Declarant's Rights. Declarant may at any time, and from time to time, assign all or any portion of its rights in this Declaration with respect to all or any portion of the Properties to the Committee established in this Article. Unless and until Declarant assigns any of its rights to the Committee, Declarant may unilaterally (i.e., without approval of the Board of the Association, the Members or any other Owner) by Recorded instrument (i) reasonably amend from time to time the procedures for granting or denying approvals, as set forth in this Article 3, and (ii) terminate or modify the requirements for architectural review and approval by Declarant or the Committee as provided in this Declaration with respect to all or any portion of the Property in which event this Declaration shall remain in full force and effect except for the provisions so terminated or modified.

3.3 Members of Committee. The Architectural Review and Design Review Committee, sometimes referred to in this Declaration as the "Committee," shall consist of three (3) members. The initial members of the Committee shall be representatives of Declarant. Declarant shall have the right and power at all times to appoint and remove a majority of the members of the Committee or to fill any vacancy of such majority until such time as Declarant's Class B membership voting rights shall cease as provided in Section 1.5; provided, however, that Declarant may, prior to such date, transfer Declarant's rights of appointment to the Owners of a majority of the Lots by Recorded instrument. In any event the Owners of a majority of the Lots may appoint and remove at least one (1) member of the Committee. After Declarant's Class B membership voting rights cease or upon such earlier date as Declarant may have transferred Declarant's right to appoint a majority of the members of the Committee, the Owners shall have the power to appoint and remove all of the members of the Committee by vote of the Members. If and when Declarant assigns any of its rights to the

Committee, as provided in Section 3.2 above, the Committee shall begin to function as a committee. The Committee shall have the right and duty to promulgate reasonable standards against which to examine any request made pursuant to this Article, in order to ensure that the proposed plans conform harmoniously to the exterior design and existing materials of the Buildings in the Project. Association Board members may also serve as Committee members.

3.4 Removal. The right to remove any member or alternate member of the Committee shall be and is hereby vested solely in the Declarant until such time as Declarant shall transfer and assign such rights to the Association, at which time, the Association, through its Board shall possess such rights.

3.5 Terms of Office. The term of all Committee members appointed shall be one (1) year. Any new member appointed to replace a member who has resigned or has been removed shall serve such member's unexpired term. Members whose terms have expired may be reappointed.

3.6 Resignations: Vacancies. Any member of the Committee may, at any time, resign from the Committee upon written notice to Declarant and the Board.

3.7 Duties and Appeals. It shall be the duty of the Committee to perform the functions required of it pursuant to this Declaration; to consider and act upon each Application which is submitted to it pursuant to the terms of this Declaration; to enforce the Design Guidelines if any are adopted; and to perform all other duties delegated to it by the Operator or imposed upon it by this Declaration. Any Owner may appeal any decision of the Committee upon written notice to the Committee.

3.8 Meetings. The Committee shall meet as often as it, in its sole, absolute and unfettered discretion, considers necessary or proper to perform properly its duties and obligations pursuant to this Declaration. The vote, written consent or written approval of any two (2) members shall constitute an act by the Committee, unless the unanimous decision of its members is otherwise required pursuant to this Declaration. The Committee shall keep written records of all actions the Committee takes.

3.9 Design Guidelines. The Committee may, from time to time, and in its sole, absolute and unfettered discretion, adopt Design Guidelines and amend any Design Guidelines adopted by the Committee; provided, however, that no such amendment shall apply to any previously approved (or deemed approved) Improvement within the Project, and provided further that to the extent the City Design Review Board imposes more stringent design criteria than that adopted by the Committee in the Design Guidelines, the Design Review Board criteria shall control. The Design Guidelines may include (a) standards and procedures for Committee review; and (b) guidelines for Improvements, which may include, but not necessarily be limited to, guidelines for the architectural design of Improvements, site plans, floor plans and exterior elevations, the size and location of buildings (including setback requirements), the height of Buildings (including architectural features), the location and pitch of slopes, requirements for grading, excavation and drainage, the location and capacity of facilities for utilities, parking areas, loading areas and docks, trash areas (including compactor pads), Exclusive Use Areas, landscaping designs and irrigation plans, color schemes, signs, exterior lighting, and finishes and materials for use in the Project. Notwithstanding the foregoing, and notwithstanding anything in any Design Guidelines to the contrary (or which may be interpreted as being to the contrary), the following are exempt from the Design Guidelines: (i) Improvements existing or under construction on the date of recordation of this Declaration; (ii) Improvements for which the discretionary governmental approvals have been obtained from the City before the date of this Declaration; (iii) the repair, restoration and/or reconstruction of those Improvements identified in (i) and (ii) above in the event of partial or total destruction or damage thereof which is not intentionally caused by the Owner.

3.10 Variances. Subject to approval by the City of Goleta, Declarant or the Committee may authorize variances from compliance with any of the architectural provisions of this Declaration, including restrictions upon height, size, floor area or placement of structures, or similar restrictions, when circumstances such as topography, natural obstructions, hardship, aesthetic or environmental consideration may require. Such variances must be evidenced in writing and signed by an authorized representative of Declarant or the Committee. If such variances are granted, no violation of the covenants, conditions and restrictions contained in this Declaration shall be deemed to have occurred with respect to the matter for which the variance was granted. The granting of such a variance shall not operate to waive any of the terms and provisions of this Declaration for any purpose except as to the particular property and particular provision hereof covered by the variance, nor shall it affect in any way the Owner's obligation to comply with all Laws.

3.11 Design Review Fees; Compensation of Members. The Committee may establish and make available to the Owners reasonable procedural rules and may assess reasonable design review fees to defray the expenses of any and all architectural review. Such design review fees shall be imposed with respect to any submission of plans in connection with review of plans and specifications including, without limitation, the number of sets of plans to be submitted. The members of the Committee shall receive no compensation for services rendered, other than design review fees as provided herein and reimbursement for expenses incurred by them in the performance of their duties hereunder, which may include without limitation, fees for retention of professional architects, engineers and other design consultants to assist the Committee in the processing of plans and specifications and rendering of approvals and performance of the Committee's duties under this Article 3.

ARTICLE 4
DUTIES AND POWERS OF OPERATOR

4.1 Operator Duties and Powers. Declarant shall initially exercise all of the rights and powers of the Operator set forth in this Declaration (including, without limitation, under Article 6 hereof), unless and until any or all of such rights and powers are assigned by Declarant as provided in this Declaration. After formation of the Association, if and when any or all of such rights are assigned by Declarant to the Association, any consent or approval previously given by Declarant in the exercise of such rights and powers as Operator shall be binding upon the Association and all Owners. The Operator shall be charged with the duties and shall have all the powers set forth in this Declaration, including, but not limited to, the following:

(a) Assessments. The Operator shall fix, levy, collect and enforce Assessments as described in Article 2.

(b) Common Areas. The Operator shall maintain, repair, replace, restore, operate, control and manage all Common Area Lots and all Common Areas of the Project wherever located and all facilities, Improvements and equipment located thereon, including without limitation, all Common Water Lines, Common Utility Lines, Common Landscaping and Common Parking Areas as further described in Article 8 below, except to the extent such maintenance has been assumed by a governmental agency or public or private utility, and except as otherwise set forth herein. The Operator may employ or contract with third party managers, employees or other persons to manage the Common Area Lots and other Project Common Areas on behalf of the Operator. The Owner of each Lot covenants and agrees to the foregoing and that it shall cooperate with the Operator in the administration of this Declaration. Nothing in this Section or elsewhere in this Declaration shall preclude or be interpreted as precluding the Operator from retaining a "managing agent" within the meaning of §1363.1 of the California Civil Code, as it may be amended or replaced from time to time, to perform all or any portion of the duties and responsibilities of the Operator. If the Operator so retains such a "managing agent," then the "managing agent" and the Operator shall make all arrangements necessary or proper to ensure that funds accepted or received by the "managing agent" and belonging to the Operator are deposited and handled in compliance with §1363.2 of the California Civil Code, as it may be amended or replaced from time to time. The Operator may retain an affiliate of Declarant as managing agent and the Operator may contract for equipment, tools, supplies and other goods for the Common Area and may employ personnel necessary for the effective operation and maintenance of the Common Area.

(c) Exclusive Use Areas. To the extent, and only to the extent, the Operator assumes the obligations of any Owner(s) to maintain, repair, insure, replace, restore, operate, control and manage the Exclusive Use Area(s) of such Owner(s), including, without limitation, any Private Water Lines, the Operator shall maintain, repair, insure, replace, restore, operate, control and manage such Exclusive Use Area(s) and all Exclusive Use Improvements, as further described in Article 8 below, except to the extent such maintenance has been assumed by a governmental agency or public or private utility, and except as otherwise set forth herein. At the request of any Owners sharing rights to any Exclusive Use Areas, the Operator may, but shall not be obligated to, administer the operation of such Exclusive Use Areas as between the Owners entitled to use such Exclusive Use Areas and as between such Owners and all other Owners, Occupants and Permittees of the Project.

(d) Discharge of Liens. The Operator shall discharge by payment, if necessary, any lien against the Common Area Lots or any other Common Areas of the Project or any portion thereof, and, if placed thereon as a result of the action of an Owner or Owners, assess the cost thereof as a Reimbursement Assessment (as described in Section 2.7) to the Owner or Owners responsible therefor; provided, however, that such Owner or Owners shall be given notice of the lien and the proposed discharge at least fifteen (15) days prior to discharge by the Operator, any opportunity to be heard by the Operator, either orally or in writing, at least five (5) days prior to the proposed discharge and before a decisions to discharge is made.

(e) Payment of Expenses. The Operator shall pay all expenses and obligations incurred by the Operator in the conduct of its business, including, without limitation, all licenses, Common Expenses, Common Water Costs and Common Parking Expenses, costs of water to the Project provided by GWD, Real Property Taxes and governmental charges levied or imposed against any and all Common Area Lots.

(f) **Adoption of Rules.** The Operator may adopt reasonable, non-discriminatory "Rules and Regulations" not inconsistent with this Declaration. The Rules and Regulations shall relate to the use of the Common Area and all facilities thereon, and to the conduct of Occupants and Permittees with respect to the Project and the Owners. Such Rules and Regulations shall be binding upon all Occupants and Permittees.

(g) **Access; Right of Entry.** For the purpose of performing any act reasonably related to the performance by Operator of its responsibilities or the exercise by Operator of its rights hereunder, Operator and the agents or employees of Operator shall have the right after reasonable notice (except in cases of regular, routine maintenance and emergencies where no notice shall be necessary) to enter any Lot, whether or not within the Common Area. In addition, Operator and its authorized agents, representatives, assignees and employees, and the City and its authorized representatives shall have the right to enter upon and inspect any Lot and the exterior of any Building or Building Appurtenances for the purpose of ascertaining whether or not the provisions of this Declaration have been or are being complied with, and take whatever corrective action may be deemed necessary or proper, consistent with the provisions of this Declaration, and shall not be deemed guilty of or liable for trespass by reason of such entry. However, nothing herein shall be construed to impose any obligation upon Operator to maintain or repair any portion of any Lot or Improvement thereon which is to be maintained or repaired by the Owner thereof. Each Owner shall permit access to such Owner's Lot and the exterior of any Building or Building Appurtenances on such Owner's Lot by any Person authorized by Operator, as Operator may deem reasonably necessary, to perform any act reasonably related to the performance by Operator of its responsibilities or rights hereunder. Each Owner hereby waives all claims for damages for any injury or inconvenience to or interference with Owner's business, any loss of occupancy or quiet enjoyment of the Building or Lot, any claim of trespass or any other loss occasioned by Operator's entry upon a Lot or Improvement thereon pursuant to this paragraph.

(h) **Enforcement.** Operator shall have the authority to enforce this Declaration in accordance with the provisions of Article 20, below.

(i) **Acquisition and Transfer of the Project.** Operator shall have the power to acquire (by gift, purchase, or otherwise), own, hold, improve, build upon, operate, maintain, convey, sell, lease, transfer, dedicate for public use, or otherwise dispose of real and/or personal property in connection with the management of the Common Area and the administration of this Declaration, including, without limitation, the right to transfer the Common Area Lot(s) to the Association or to the City or any third party.

(j) **Contracts.** Operator shall have the power to contract for goods and services for the Common Area in fulfilling its obligations hereunder including, without limitation, contracting with GWD or any successor water agency for water service to the Project.

(k) **Parking Regulation and Control.** Operator shall have the power to regulate and allocate parking and to establish "parking", Reserved Parking, "after hours parking" and "no parking" areas within the Common Parking Areas, all subject to the terms of this Declaration and approval by the City of Goleta, including without limitation, the provisions of Section 7.2, but the Operator shall not have the right to regulate Exclusive Parking Areas located upon any Building Lot which are intended to serve only the Owner, Occupants, and Permittees of such Building Lot, such Exclusive Parking Areas to be regulated solely by the Owner of such Building Lot. The Operator's power includes, without limitation, the right to erect Improvements within the Common Area and implement policies to control, restrict or provide for additional parking by the Project Occupants and Permittees and the public, for the benefit of the Project as a whole, including without limitation, the power to grant the right to use non-exclusive Common Parking Areas after normal business hours of the Project as described in Section 7.2 to the public and third parties that are not Occupants of the Project or Permittees of any particular Owner or Occupant of the Project, as well as the right to grant and reserve designated parking spaces within the Common Parking Areas for the benefit of specific Occupants of the Project and their Occupants and Permittees such as delivery vehicle parking, short term ATM or other pick-up, drop-off and/or delivery type parking, all subject to the terms of this Declaration and provided that at all times parking within the Project is maintained so as to comply with all applicable Laws. The Operator shall exercise such rights and powers in accordance with the terms of this Declaration so as to preserve the rights of all Owners, Occupant and Permittees with parking rights in the Common Parking Areas.

(l) **Security.** Operator shall have the right to reasonably establish and modify levels of security personnel, services and/or equipment for the Common Areas of the Project as the Operator may from time to time determine in the exercise of its reasonable discretion. Costs of any such Common Area security personnel, services and/or equipment shall constitute Common Expenses, except to the extent the need for any such security arises solely as the result of the conduct or use of any Owner or Occupant of the Project, in which event, such security costs shall be charged to such Owner or Occupant as a Special Assessment. Security personnel, equipment and services for any Buildings within the Project shall be subject to the determination of each Building Owner, but may be implemented in coordination with Common Area security with the Operator's approval and at the expense of the Building Owner(s) requesting such coordinated security implementation.

(m) Insurance. Operator shall maintain insurance for all Common Area Lots and all other Common Areas of the Project as provided in Section 8.9 of this Declaration.

4.2 Transfer of Interest and Obligations of Declarant and Operator.

(a) Permissive Transfers by Declarant. Any and all of the rights, powers and reservations of Declarant set forth herein may be assigned by Declarant to any person or entity, provided such assignee agrees in writing to accept such assignment and to assume the duties of Declarant pertaining thereto arising after the date of such assignment. An assignee may succeed to the same rights, powers and reservations and be subject to the same obligations and duties as are herein given to and assumed by Declarant, as a successor Declarant, provided such assignee: (a) holds or acquires record title to all or any portion of the Project; and (b) Declarant (or a successor Declarant) executes and records a document which expressly names such party as successor Declarant and assigns the rights and duties of Declarant hereunder. Notwithstanding any provision of this Declaration to the contrary, Declarant may, at any time, relieve itself of its rights and obligations under this Declaration by recording a notice stating that Declarant has surrendered said rights and obligations and, upon recordation of such notice, even if it is not specified therein, said powers and obligations shall immediately vest in the Association, in accordance with Article 1. If at any time Declarant ceases to exist and has not made such an assignment, the rights and obligations of Declarant shall automatically vest in the Association, in accordance with Article 1.

(b) Operator Transfers to Managing Agent. Nothing in this Declaration shall preclude or be interpreted as precluding the Operator from retaining a "managing agent" within the meaning of §1363.1 of the California Civil Code, as it may be amended or replaced from time to time, to perform all or any portion of the duties and responsibilities of the Operator. If Operator so retains such a "managing agent," then the "managing agent" and the Operator shall make all arrangements necessary or proper to ensure that funds accepted or received by the "managing agent" and belonging to Operator are deposited and handled in compliance with §1363.2 of the California Civil Code, as it may be amended or replaced from time to time. In all events, so long as Declarant is Operator, Declarant or an affiliate of Declarant may act as managing agent.

4.3 Termination of Responsibility. The responsibilities of Declarant or its transferee pursuant to this Declaration including, without limitation, all responsibilities as Operator, shall cease at the time Declarant or its transferee ceases to own any interest (including a security interest) in the Project. Upon such transfer, the Association (pursuant to Article 1) shall assume all of the obligations and succeed to all of the rights and powers of Declarant as set forth herein.

ARTICLE 5
PERMITTED AND PROHIBITED USES

5.1 Permitted Uses. Unless otherwise specifically prohibited herein, Permitted Uses shall include those uses permitted by applicable City zoning and land use regulations, provided such use is performed and carried out entirely within a Building that is so designed and constructed that the operations and uses comply with: (a) all Laws and (b) the provisions of this Declaration. If any applicable Laws are less restrictive than the provisions of this Declaration, the more restrictive provisions shall apply.

5.2 Prohibited Uses. The following uses shall be prohibited within the Project: any residential uses; trailer courts; mobile home parks; recreational vehicle campgrounds; junk yards; commercial excavation of building or construction materials, except in the usual course of construction of improvements; dumping, disposal, incineration or reduction of garbage, sewage, offal, dead animals or refuse; stockyards or slaughter of animals; refining of petroleum or of its products; smelting of iron, tin, zinc or other ores; cemeteries or burial services; jails and honor farms, labor camps or migrant worker camps; petroleum storage yards and/or munitions-related manufacturing or storage activities. In addition, there shall not be permitted any use which would be offensive by reason of odor or fumes (other than odors or fumes ordinarily emitted by uses commonly associated with mixed use commercial developments similar to the Project type including, without limitation, as from restaurants), dust, smoke, noise or pollution, or hazardous (beyond legally mandated limits) by reason of danger of fire or explosion. Uses which are neither expressly approved nor disapproved hereunder, may be approved only with the prior written consent of the Association Board.

5.3 Nuisances. No Owner or Occupant shall create or permit any public or private nuisance on any portion of the Project. All incinerators or other equipment for the storage or disposal of trash, garbage or refuse shall be kept in a clean and sanitary condition. No odors shall be permitted to arise therefrom so as to render any Lot or portion thereof unsanitary, unsightly, offensive or detrimental to any property in the vicinity or to the Occupants thereof. No use or operation shall be conducted in the Project which is noxious, offensive, unsightly or which may interfere with the quiet enjoyment of other Owners and Occupants.

5.4 Necessary Permits. Prior to commencement of any operation or use upon a Lot, each Owner or Occupant, shall demonstrate to the Committee that Owner has obtained all necessary permits for the operation or use proposed by such party.

5.5 Other Operations and Uses. Operations and uses which are neither specifically prohibited nor specifically authorized by this Declaration may be permitted in a specific case if an Application containing operational plans and specifications are submitted to and approved in writing by the Committee. Approval or disapproval of and compatibility with such operational plans and specifications shall be based upon the effect of such proposed operations or uses on the balance of the Project and the Owners and Occupants thereof, but shall be in the sole discretion of the Committee. Prior to submitting an application to and seeking approval from the City, or any other governmental or quasi-governmental agency having jurisdiction over the Project, of any permit or approval (or any amendment or modification to any previously approved permit or approval) relating to the use, development and construction of Improvements upon any Lot not previously approved and/or exempted from the provisions of this Declaration, the Owner or Occupant shall submit the same to the Committee in accordance with Article 6 hereof.

5.6 Laws. No Owner or Occupant shall permit any activity, use or operation on any portion of the Project in violation of any Law. Each Owner and Occupant shall, upon written notice from Declarant, or the Operator, discontinue any use which is finally determined by any governmental entity having such jurisdiction to be a violation of any Law. Each Owner and Occupant shall, immediately upon receipt from any governmental entity of an alleged violation of any Law, provide a copy of such allegation to the Operator, notwithstanding such party's belief that meritorious defenses to such allegations exist.

ARTICLE 6
REGULATION OF IMPROVEMENTS

6.1 Approval of Application Required. Except as provided in this Article 6, no Improvement shall be constructed, reconstructed, rebuilt, erected, placed, altered, used, maintained or permitted to remain in the Project (i) unless the Improvement and intended use thereof conforms with all applicable Laws and this Declaration; and (ii) until plans, specifications and other documentation required by the Committee (or as otherwise specified in any Design Guidelines adopted by the Committee) for the Improvement and the intended use thereof (**"Application"**) have been submitted to and approved in writing by the Committee. Notwithstanding the foregoing, the following Improvements shall be exempt from the provisions of this Article 6 and are not required to be the subject of an Application pursuant to this Article 6: (i) Improvements existing or under construction on the date of recordation of this Declaration, except to the extent materially modified after the date of recordation of this Declaration; (ii) Improvements which are substantially consistent with the Site Plans and for which the discretionary governmental approvals have been obtained from the City before the date of this Declaration; (iii) Improvements within the interior of a Building such as tenant improvements, lobbies and other interior space; and (iv) the repair, restoration and/or reconstruction of those Improvements identified in (i), (ii) and (iii) above in the event of partial or total destruction or damage thereof which is not caused by Owner, and to the extent such Improvements are restored to substantially the same configuration, elevation and with materials and colors substantially similar to the Improvements in place prior to such damage or destruction. Each Application, including all exhibits and supporting materials and documentation, must be submitted in duplicate. Such Applications shall be in such form and shall contain such information as may be required by the Committee, but shall in any event include the following:

(a) A site development plan of the Lot showing the nature, grading scheme, kind, shape, composition, and location of all structures with respect to the particular Lot (including proposed front, rear and side setback lines), and with respect to structures on adjoining Lots, and the number and location of all parking spaces and driveways on the Lot, if any;

(b) A landscaping plan for the particular Lot;

(c) A plan for the location of signs and lighting; and

(d) A building elevation plan showing dimensions, materials and exterior color scheme in no less detail than required by the appropriate governmental authority for the issuance of a building permit.

Material changes to previously approved plans must be similarly submitted to and approved by the Committee.

6.2 Basis for Disapproval. The Committee shall have the right to disapprove an Application submitted to it in the event any part of the Application: (a) is not in accordance with this Declaration, and any Design Guidelines or other requirements adopted by the Committee; or (b) is incomplete; or (c) is not in compliance with the applicable governmental approvals and regulations for the Project, or other City development standards and reputations applicable to the Property, including without limitation City Design Review Board plans or requirements; or (d) is deemed by the Committee to be contrary to the best interests of the Project or the Owners; or (e) any combination of the foregoing. The Committee shall not unreasonably withhold its approval of an Application submitted to it, but may condition its approval on the satisfaction of one or more conditions set forth in writing. In this regard, the Committee may base its approval or disapproval on criteria which may include, but are not limited to, the following: (i) the adequacy of the Building locations and dimensions on the Lot; (ii) the adequacy of the parking to be provided; (iii) conformity and harmony of external design with neighboring structures; (iv) effect of location and proposed use of proposed Improvements on neighboring Lots and the types of operations and uses thereof; (v) relation of topography, grade and finish ground elevation of the Lot being improved

to that of neighboring Lots; (vi) proper facing of main elevation with respect to nearby streets and other buildings; (vii) adequacy of screening trash facilities and mechanical, air conditioning or other rooftop installations; (viii) adequacy of landscaping; and (ix) conformity of the Application to the purpose and general plan and intent of this Declaration. No Application shall be approved which does not provide for the underground installation of all utility services. The Committee may condition its approval of an Application on such changes therein as it deems appropriate such as, and without limitation, the approval of such Improvements by a holder of an easement which may be impaired thereby or upon approval of any such Improvements by the appropriate governmental entity. Any Committee approval conditioned upon the approval by a governmental entity shall not imply the Operator is enforcing any government codes or regulations, nor shall the failure to make such conditional approval imply that any such governmental entity approval is not required. In reviewing or approving any Application, the Committee shall not be responsible for determining compliance with any governmental land use or building construction ordinances or requirements.

6.3 Result of Inaction. The Committee shall approve or disapprove an Application within thirty (30) days after receipt of a complete Application. If the Committee fails either to approve or disapprove an Application within such thirty (30) day period, then it shall be conclusively presumed that the Committee has disapproved the Application, unless the applicant has delivered to the Committee, within fifteen (15) days after the expiration of the thirty (30) day period, a notice in writing setting forth a date of initial submittal of the complete Application to the Committee and the fact that no approval or disapproval has been given as of the date of such notice. If the Committee thereafter fails to either approve or disapprove the Application on or before the fifteenth (15th) day after the Committee's receipt of such notice, the provisions of this Declaration requiring approval of such Application shall be deemed to have been waived by the Committee with respect to such Improvements; provided, however, that such waiver shall not be deemed to be a waiver of any other covenant, condition or restriction provided herein. One (1) set of the Application shall, with the approval or disapproval of the Committee endorsed thereon, be returned to the Owner submitting it, and the other set shall be retained by the Committee for its permanent files. In the case of a conditional approval of an Application, the written conditions shall accompany the Committee's written conditional approval.

6.4 Proceeding With Work. Upon the Committee's approval of an Application pursuant to this Article 6, the Owner to whom the approval is granted and delivered, shall, as soon as practicable, satisfy all conditions thereof (if any) and diligently proceed with the commencement and completion of all approved construction, refinishing, alterations, excavations and landscaping so that no Improvement remains in a partly-finished condition any longer than reasonably necessary for completion thereof. In addition, each Owner shall cause all work to be as non-disruptive as practicable to the Project and the guests, invitees, tenants, employees and Owners who use the Project. Each Owner shall disrupt traffic flow and parking as little as possible during construction and shall clean up daily any construction debris to the extent reasonably practicable. In all cases, work shall be commenced within six (6) months following the date of such approval. If work is not commenced within six (6) months following the date of such approval, then the approval given pursuant to this Article 6 shall be deemed revoked; provided, however, upon written request made prior to the expiration of said six (6) month period, the Committee may, in its sole, absolute and unfettered discretion, extend the time for commencing work.

6.5 Completion of Work. Construction, refinishing, alteration or excavation of any Improvements previously approved under this Article 6 shall be expeditiously completed and shall in all instances be completed within one (1) year following the commencement thereof, except for so long as such completion is rendered impossible or would result in hardship due to action of the elements, fire or other casualty, war, riot, labor dispute, inability to procure or general shortage of labor or material in the normal channels of trade, delay in transportation, delay in inspections, governmental action or inaction or moratorium or any other cause beyond the reasonable control of the Owner so obligated, whether similar or dissimilar to the foregoing, financial inability excepted. Failure to comply with this Section 6.5 shall constitute a breach of this Declaration and subject the defaulting Owner or Owners to all enforcement procedures set forth in this Declaration or any other remedies provided by law or in equity. Upon completion of construction of any Improvement, one complete set of as-built plans shall be submitted to and maintained by the Committee.

6.6 Estoppel Certificate. At the request and expense of any Owner, the Committee shall deliver to such Owner an estoppel certificate within thirty (30) days following receipt of a written request therefor. If the Committee does not have an as-built survey of the Owner's Lot in its files, then any such request shall be accompanied by an ALTA map of survey or a certified as-built survey of the Owner's Lot. The estoppel certificate shall certify that as of the date of the certificate either (a) all Improvements made or work done on or within the Owner's Lot comply with this Declaration; or (b) such Improvements or work do not so comply, in which event the certificate shall identify the non-complying Improvements and shall set forth the cause or causes for such noncompliance. Any existing or prospective Owner, Occupant or Mortgagee in good faith for value shall be entitled to rely on the certificate with respect to the matters set forth therein, such matters being conclusive as between the Committee and all such subsequent parties in interest.

6.7 Indemnity and Limitation of Liability. Neither Declarant, the Association, the Operator nor the Committee, nor any member of the Board or the Committee, nor any agents, employees or contractors of Declarant, the Association, the Members, Occupants, the Operator or the Committee (individually or collectively, **"Indemnitee"**) shall be liable for any liability, damage, loss, cost, expense or prejudice suffered, incurred or claimed by any Owner, Occupant or other person (an **"Applicant"**) who submits an Application, or by any other Person (including any other Owner or Occupant); and each Applicant who submits an Application shall forever hold each and every Indemnitee harmless from and against any liability, damage, loss, cost, expense or prejudice suffered, incurred or claimed by such Applicant, and shall forever indemnify, defend, protect and hold each Indemnitee harmless for any liability, damage, loss, cost, expense or prejudice suffered, incurred or claimed by any other Person (including any other Owner or Occupant), arising from, our of or in connection with (a) any defects in any plans, drawings, specifications or other documentation submitted in any Application, revised or approved in accordance with this Declaration, or for any structural or other defects in any work done according to such plans, drawings, specifications or other documentation; (b) the approval or disapproval of any Application, whether or not defective; (c) the construction or performance of any work, whether or not constructed or performed pursuant to an approved Application; (d) the development of any Lot within the Project; (e) the execution and filing of an estoppel certificate pursuant to Section 6.6, whether or not the facts therein are correct, provided that the Committee has acted in good faith in issuing such estoppel certificate on the basis of such information as may be possessed by it; or (f) any combination of the foregoing.

6.8 Development Requirements of City. The Property is subject to and each Owner shall comply with the development criteria, restrictions and other requirements set forth in all applicable governmental requirements including, without limitation the Development Agreement conditions of the City recorded June 25, 2007 and Ordinance No. 07-04. The City has the right to review and approve site development plans for each Lot pursuant to policies and standards promulgated, approved or adopted by the City, including, without limitation, the City's Zoning Ordinance The City's review may include, but shall not be limited to, sign location, landscaping, access drives and building architecture. If any requirement imposed by the City is different from a requirement contained herein, the more restrictive requirement shall prevail. Each Owner and Occupant is responsible for identifying and conforming with all City requirements.

6.9 Improvement Standards and Limitations. All standards and limitations contained in this Declaration supplement the controls established by applicable zoning, land use-related entitlements and approvals granted for development of the Project and applicable building, fire and other governmental ordinances, codes, rules and regulations; and of the foregoing, the more restrictive shall apply. Each Owner and Occupant is responsible for identifying and conforming with all Laws.

(a) Landscaping. To the extent there is any landscaping to be located upon a Building Lot, such Building Lot shall be landscaped by the Owner in accordance with the Application approved by the Committee pursuant to this Article 6 and any landscaping plans approved by the City for such Lot prior to issuance of a certificate of occupancy by the City of Goleta. If not previously installed, the Owner shall also install the Common Landscaping to be located upon such Building Lot, if any, in accordance with the plans and specifications adopted by the Declarant, or as otherwise approved by the Committee prior to issuance of a certificate of occupancy by the City of Goleta. . Once installed, landscaping in the Project shall be maintained, repaired and replaced as provided in Section 8.8 and Section 9.1 of this Declaration.

(b) Exclusive Use Areas. Exclusive Use Areas including Private Water Lines shall be maintained, repaired and replaced by the Owner(s) entitled to the exclusive use of such areas or, if agreed as between the Operator and such Owner(s), maintained, repaired and replaced by the Operator provided all costs and expenses incurred by the Operator in connection therewith shall be charged to the Owner(s) entitled to the exclusive use of such areas in accordance with Article 8.

(c) Signs. Except for street and traffic control signs and such other signs as may be required by applicable Law, and Common Signage installed by Declarant or the Operator, no sign, billboard or other advertising shall be erected, placed or maintained within the Project without written approval of the Committee.

(d) Parking Areas. The Committee shall have the authority to disapprove any Application for the construction of any Building on a Building Lot in the Project if the Application does not provide for parking on such Building Lot and/or within the Allocated Parking Spaces for such Building Lot in the Common Parking Areas in compliance with applicable ordinances, rules and regulations of the City. The purpose and intent of this requirement is to ensure that all development and parking arrangements comply with any City-imposed requirements for shared parking existing on the date of this Declaration. No Owner may lease or otherwise make use of its Lot in a manner that would result in a shortage of parking for any other Owner of any Lot(s) or otherwise cause the parking arrangements for the Project to be in violation of the terms of this Declaration or any City-imposed parking requirements.

(e) Exterior Lighting. Exterior lighting shall conform to the Design Guidelines and shall not be of such intensity, size, color or location as to be a nuisance to Owners, Occupants or the general public.

(f) Utility Lines and Antennas. No sewer, water, drainage or utility lines, cables or wires or other devices for the communication or transmission of electric current, power or signals (including, but not limited to, telephone, television, microwave or radio signals) shall be constructed, placed or maintained anywhere in or upon any Lot other than within Buildings or structures unless contained in underground conduits; provided, however, transformers and terminal equipment related thereto may be installed above ground if screened from view of adjacent streets and Lots in a manner satisfactory to the Committee. No antenna, satellite dish or disc for transmitting or receiving telephone, television, microwave or radio signals shall be placed on any Lot unless (i) such antenna, dish or disc, whether on the ground or on a Building, is screened from view of adjacent streets and Lots in a manner satisfactory to the Committee; and (ii) the prior written consent of the Committee is obtained. Nothing contained in this Section shall prohibit (x) the erection or use of temporary power or telephone facilities incidental to the construction or repair of Improvements on any Lot, or (y) the installation and maintenance of security and surveillance devices upon the exterior of Buildings, within Common Areas adjacent to such Buildings or elsewhere upon an Owner's Lot and Exclusive Use Areas. No Owner shall enter into any contract or agreement with the City, the County of Santa Barbara, the GWD or any other governmental agency or entity or public utility with respect to sewer lines or connections, water lines or connections, or street improvements (including, but not limited to, curbs, gutters, parkways, street lighting or other utility connections, lines or easements) relating to the Project or any Lot without the prior written consent of the Committee (including the Committee's approval of the contract or agreement proposed to be entered into), which may be withheld if the Committee determines such contract or agreement, or the improvements to be constructed pursuant thereto, are not consistent with the Declaration or any of the other Project Documents.

(g) Excavation and Underground Utilities. No excavation shall be made except in connection with construction of an Improvement, and upon completion thereof, exposed openings shall be back filled and disturbed ground shall be graded, leveled and restored to its original or approved similar condition.

6.10 Disclosure and Waiver of Conflict of Interest. Board and Committee members may be elected by, appointed by, affiliated with or employed by one or more Owners. If an Owner submits an Application to the Committee for approval, Committee members appointed by such Owner may have a conflict of interest in rendering their decisions. No Owner nor any Board or Committee member affiliated with such Owner shall have any liability to any other Owner, Occupant or other Person as a result of decisions which may benefit such Owner rendered in good faith by the Board, Committee or any Board or Committee member, and each Owner hereby waives any claim of liability against each other Owner, the Board, the Committee or any Board or Committee member, based upon such conflict of interest.

ARTICLE 7
OPERATIONS GENERALLY

7.1 Slope and Drainage Use. The Owner of each Lot will permit free access by Owners of adjacent or adjoining Lots and by Declarant to slopes and Common Drainage and Irrigation Facilities located on the Owner's Lot which affect such adjacent or adjoining Lots when such access is required for the maintenance of permanent stabilization on said slopes, or maintenance of the drainage facilities for the protection and use of property other than the Lot on which the slope or drainageway is located. No Owner shall in any way modify, interfere with or obstruct the established surface drainage pattern over the Owner's Lot or over any adjacent Owner's Lot from adjoining or other Lots, including any bio-swales located on any such Lots, and each Owner shall make adequate provisions for proper drainage of such Owner's Lot without modification of any established and approved drainage over the Owner's Lot. For the purpose of this paragraph, **"established"** drainage is defined as the drainage patterns at the time the overall grading of each Lot is completed in accordance with the City-approved grading plans therefor. Upon completion of final grading of a Lot, no surface drainage shall be directed across any portion of an adjoining Lot (unless an easement for such purpose is granted herein or on the Final Map); all surface drainage shall be directed to a public or private street or into the underground drainage system. Each Owner shall maintain, repair and keep free from debris or obstruction the drainage system and facilities (if any) located on his Lot.

7.2 Parking; Common Parking Areas; Parking Regulations.

(a) The Owners intend that this Declaration satisfy any City-imposed requirements for shared parking existing on the date of this Declaration.

(b) All Common Parking Areas of the Project shall, unless designated by the Operator as Reserved Parking Spaces as provided in this Declaration, be available for use by the Owners, Occupants and Permittees of all Building Lots which the Operator may designate as being entitled to use such Common Parking Areas in this Declaration, concurrently with the grant and conveyance of the Building Lots or pursuant to a separate written agreement between Declarant and such Building Lot Owner in accordance with the terms of this Declaration. Any Exclusive Parking Area shall be available for use solely by the Owners, Occupants and Permittees of the Building Lot upon which such Exclusive Parking Area is situated.

(c) All portions of the Common Parking Areas shall be non-exclusive among the Owners, Occupants and Permittees entitled to use such facilities and such other parties to whom the Operator may grant rights to the use of non-exclusive Common

Parking Areas after normal business hours for the Project, except that the Operator shall have the right to designate from time to time portions of the Common Parking Areas as Reserved Parking Spaces reserved for the exclusive use and enjoyment of one or more Owners and their respective Occupants and Permittees, provided (i) each Building Lot Owner shall be entitled to have the Operator establish and reserve for the exclusive use of such Building Lot Owner and the Occupants and Permittees of such Building Lot up to five percent (5%) of the total Allocated Parking Spaces allocated to such Building Lot (as described and reflected in **Exhibit "D"),** as Reserved Parking Spaces, and (ii) all Reserved Parking Spaces allocated to any Owner shall be deemed to be part of the total Allocated Parking Spaces which are allocated to such Owner, and (iii) in granting such Reserved Parking Spaces there shall always remain available to all other Owners and Occupants such Owners' and Occupants' respective Allocated Parking Spaces (both reserved and unreserved). Each Building Lot Owner's Allocated Parking Spaces includes such Building Lot Owner's allocable share of visitor and handicapped parking spaces. Operator shall have the right to establish the location of such Reserved Parking Spaces for all Building Lot Owners on a reasonable and equitable basis in its reasonable discretion. Each Building Lot shall have the right to sell at any price desired by such Owner, or to otherwise provide to, itself and its Occupants, the right to the use and enjoyment of such Reserved Parking Spaces. In designating the location of Reserved Parking Spaces, the Operator shall use its reasonable business judgment and endeavor to designate the location of all Reserved Parking Spaces on a reasonable, fair equitable and non-discriminatory manner, and shall, where appropriate, consider proximity of the Reserved Parking Spaces to the Owner's Building and access to exits, stairwells and elevators. In the exercise of its reasonable business judgment, the Operator shall have the right to grant to the public including third parties that are not Owners or Occupants of the Project or Permittees of any particular Owner, rights to utilize Common Parking Areas on an unreserved "as-available" and non-exclusive basis that shall fairly reflect such third parties' actual usage of the Common Parking Areas or to accommodate such third party user's parking requirements after normal business hours, including granting to such third party users, parking allotments greater than that allocated or required by such parties by applicable Laws, for time periods after "business hours" i.e., before 8:00 a.m. and after 6:00 p.m. Mondays through Fridays, and at all times on Saturdays, Sundays and holidays, as limited by the provisions of this Section 7.2 and additional restrictions Operator may impose on such usage, and provided in any event, no such special parking rights shall materially and adversely diminish the parking rights granted herein to the Owners, Occupants and Permittees entitled to use the Common Parking Areas of the Project. No Building Site Owner shall allow any of its Occupants or Permittees to mark or designate any portion of the Common Parking Areas, establish signs thereon or chain or block off any portion of the Common Parking Areas for the exclusive use of such Owner's Occupants or Permittees. All Building Site Owners shall cause all Occupants and Permittees to park their vehicles only within parking areas located upon such Owner's Building Lot and in those portions of the Common Parking Areas which are designated by the Operator for that purpose. Each Building Site Owner assumes responsibility for compliance by its Occupants and Permittees with each of the Governing Documents, including, without limitation, all of the terms and provisions of this Declaration (including, without limitation, those pertaining to parking provisions contained herein and rules promulgated from time to time by Operator pursuant hereto). Each Owner authorizes the Operator to cause to be towed away any vehicle belonging to any Owner, Occupant or Permittee parking in violation of these provisions, and/or to attach violation stickers or notices to such vehicle. If the Operator elects, or is required by the City, to limit or control parking by Occupants and Permittees of the Property including the public or other third parties authorized by the Operator to utilize such parking, whether by validation of parking tickets, parking meters or any other method of assessment, or to undertake any program for bus, rapid transit, free or reduced cost transportation, each Building Site Owner agrees to participate in such validation, assessment or transportation program under such reasonable rules and regulations as are from time to time established by the Operator with respect thereto, provided revenue derived from any parking charges derived from any Common Parking Areas in the Project shall be used to offset Common Parking Expenses. Notwithstanding the foregoing, there shall be no charge to the general public for non-exclusive after business hours (including on weekends) parking within the Common Parking Areas of the Project or for any parking for the general public to access and utilize open space, park and wildlife areas within the Project and the Operator shall cause portions of the Common Parking Areas reasonably proximate to such open space, park and wildlife areas to remain open and free of charge to the general public for such use. Nothing contained herein shall be deemed to create liability upon Declarant, the Association or the Operator for any damage to motor vehicles of any Owner, Occupant or Permittee or from loss of property with regard to such motor vehicles.

(d) No commercial truck is permitted to be parked on any Lot unless hidden from view from other Lots within the Project and from public and private streets by attractive visual barriers. Notwithstanding the immediately preceding sentence, commercial trucks may park for the purpose of loading and unloading on all Lots; provided, however, reasonable restrictions concerning permitted times for parking, loading and unloading commercial trucks, which may be applicable to one or more Lots, may be adopted by the Operator.

(e) Any implementation of parking controls over any Common Parking Areas or Exclusive Parking Areas shall be subject to the approval of the Operator. Subject to the provisions of Section 7.2(c) above regarding free public access and parking, the Operator may install a card access system for any of the Common Parking Areas and receive reimbursement through Common Parking Expense charges from the Owners and Occupants of all Building Lots entitled to use such Common Parking Areas for the cost of installing such system and the cost of access cards and replacement cards. The Operator shall, upon request by any Building Site Owner, issue appropriate parking access cards or other access means to each holder of Monthly Parking Privileges. Each Owner's allocable share of such costs shall be computed in the same manner as each Owner's share of other Common Parking Expenses. Occupant's payments of monthly charges for Monthly Parking Privileges may be paid to the Operator or directly to the Operator's designated parking operator. In connection with the implementation of parking controls for the Project, the Operator may, subject to approval by the Owners, and subject to the provisions of Section 7.2(c) above regarding free public access and parking, implement paid parking for visitors to the Project. Each Building Site Owner shall have the right to purchase from the Operator visitor parking validations at such price as may be established from time to time by the Operator. All income received from the sale of visitor parking validations shall be applied to and deducted from Common Parking Expenses otherwise payable by the Owners.

(f) Each Building Lot Owner shall be responsible for constructing or otherwise causing the construction of additional parking spaces on a Common Area Lot and/or upon such Owner's Building Lot, as necessary to satisfy all Laws in connection with the construction of a Building on such Owner's Lot.

(g) Declarant reserves the right to relocate, at its expense, any Common Parking Areas of which it is an Owner so long as alternative interim and permanent parking is provided for all Owners, Occupants and Permittees entitled to utilize such relocated parking, in an amount sufficient to conform with the City zoning requirements and any more restrictive parking requirements that may be established by Declarant or the Operator pursuant to a written agreement with any Owner. Nothing contained herein shall be deemed to prohibit Declarant or the Operator from imposing transient hourly and/or monthly parking fees for Occupant and Permittee parking.

(h) Occupants within the Project will have widely varying parking requirements. To ensure Common Parking Areas and Reserved Parking Spaces are used in the most efficient manner and in the best interest of all Occupants entitled to the use thereof, the Operator may adopt from time to time reasonable rules and regulations governing the use of the Common Parking Areas and Reserved Parking Spaces as well as systems required to implement any the City Transportation Demand Management requirements ("TDM Plan") or "park and ride" program, if any, as may be required and approved for the Project by the City or any other governmental authority. Each Owner shall furnish the Operator with a list of its employees and the license numbers of their vehicles within fifteen (15) days after Operator requests such information. Except as may be required by any "TDM Plan" with respect to "park and ride" facilities, if any, each Owner shall be responsible for ensuring that its employees and the employees of its Occupants and Permittees comply with all the provisions of this Section 7.2(j) and such other parking rules and regulations as may be adopted and implemented by the Operator from time to time, including, but not limited to, systems of validation, shuttle transportation or any other programs which may be deemed necessary or appropriate by the Operator to control, regulate or assist parking in the Project in accordance with the terms of this Declaration. No vehicle shall be parked on a Lot other than within striped parking spaces thereon, within a Building or within a storage area prepared in accordance with this Declaration, except temporarily while loading or unloading at a doorway or loading area of a Building. Except for Lots 9 and 10 until such time as new buildings are constructed on such Lots (at which time the following restriction shall also apply to Lots 9 and 10), no Person shall store or keep anywhere on a Lot or any public street abutting such Lot, (i) any inoperable commercial vehicle, dump truck, cement mixer truck, oil or gas truck, or (ii) any operable or inoperable camping trailer, boat, aircraft, mobile home, recreational vehicle, motor home or any other similar vehicle except within an enclosed building or behind a visual barrier, prepared in accordance with Article 5 hereof, screening the sight of such vehicles from the building pads on the other Lots within the Property. No Person shall conduct repairs, restorations, or painting of any motor vehicle, boat, trailer, aircraft or other vehicle upon any portion of the Property except wholly within an enclosed Building. No parking shall be permitted which may obstruct free traffic flow, constitute a nuisance, or otherwise create a safety hazard.

(i) Because the foregoing uses involve the potential for overburdening of the Common Parking Areas, if such overburden occurs, the Operator shall take action to mitigate the problem as provided below:

(i) **Overburden Trigger.** If either the Operator receives written notice from an Owner to monitor the Common Parking Areas as provided herein or the Operator determines that the Common Parking Areas appear to be overburdened, the Operator shall monitor the Common Parking Areas to determine if the Common Parking Areas are overburdened. Use of the Common Parking Areas shall be deemed to be overburdened when the occupancy of the Common Parking Facilities is on average over ninety-five percent (95%) occupied for five (5) consecutive days, checked three (3) times per day at least one (1) hour apart, between the hours of 8:00 a.m. and 6:00 p.m., Saturdays, Sundays and holidays excluded. If any such overburden of the Common Parking Areas occurs, the Operator shall take the mitigation measures provided in subparagraph (ii) below.

(ii) **Mitigation Measures.** If any overburdening of the Common Parking Areas occurs as provided in (i) above, the Operator shall take the following mitigation measures in the following order as needed: (1) reduce or eliminate any excess parking use by any parties who are not Owners, Occupants or Permittees of the Project, if any; (2) reduce or eliminate the use by any Owner or its Occupants found to be overburdening the Common Parking Areas; and/or (3) take any other reasonable action.

The purpose for the above overburden/mitigation provision is solely to provide a failsafe mechanism should the Common Parking Areas become seriously overburdened. This provision is not in any way intended to set the maximum amount of Allocated Parking Spaces or parking rights for the Common Parking Areas, or to otherwise be used as a basis for issuing additional Allocated Parking Spaces or any other parking rights or privileges.

7.3 **Storage and Loading Areas.** Except with respect to Lots 3, 8, 11,12 and 14 and the existing Range building on Lots 9 and 10 until such time as such Improvements are removed and Lots 9 and 10 are re-developed, subject to Committee approval, which may be withheld in its sole, absolute and unfettered discretion:

(a) No materials, supplies or equipment shall be stored in any area on a Lot, except inside a closed Building or on a temporary basis behind a Committee approved visual barrier which screens such areas from the view of adjoining Lots and public streets.

(b) Loading areas and docks shall be set back and screened to minimize the visual and noise effects from the street in accordance with the requirements of the Conditions of Approval for the Map. All loading areas shall be hidden from view from public streets by visual barriers approved by the Committee. Notwithstanding the foregoing, it may not be practical or feasible for all loading areas and docks to comply with this restriction, in which event, as to those loading areas and docks, the Committee shall have the right to designate hours for loading and unloading and the rules reasonably necessary to minimize the visual and noise effects thereof.

(c) Any shared loading areas shall be maintained and repaired by the Operator and the costs associated therewith shall be charged by the Operator to the Owners entitled to the use of such shared loading areas on an equitable basis as reasonably determined by the Operator.

7.4 **Inspection.** Declarant, members of the Operator, members of the Committee and their authorized representatives may from time to time, at any reasonable hours, enter upon and inspect any Lot, or any portion thereof, or Improvements thereon, to ascertain compliance with this Declaration and other Project Documents, but without obligation to do so or liability therefor provided, however, no such entry shall be permitted to inspect the interior or exterior of any Building Improvements without at least five (5) business days' prior written notice and a statement for the reasons such entry is permitted or required under the Project Documents.

7.5 **Division of Land.** No Lot shall be subdivided or re-subdivided without the prior written approval of Declarant (or the Operator, if there is no Declarant) which may be withheld in its sole, absolute and unfettered discretion and all other required government approvals. If a subdivision or re-subdivision of a Lot is so approved, each of the Lots created as a result of the subdivision or re-subdivision shall be subject to this Declaration and the other Project Documents.

7.6 **Hazardous Materials.** Each Owner with respect to the Lot(s) owned by such Owner covenants to do as follows:

(a) At all times and in all respects to comply, and cause all of its Occupants to comply, with all Environmental Laws regarding the use, storage and disposal of Hazardous Materials.

(b) Each Owner shall cause its Occupants and Permittees to procure, maintain in effect and comply with all conditions of any and all permits, licenses, and other governmental and regulatory approvals required for its or its use of the Project, including, without limitation, discharge of (appropriately treated) materials or wastes into or through any sanitary sewer serving the Project. Except as discharged into the sanitary sewer in strict accordance and conformity with all applicable Environmental Laws, no Person shall cause any Hazardous Materials removed from the Project to be removed and transported except solely by duly licensed haulers to duly licensed facilities for final disposal of such materials and wastes. Each Owner, Occupant and user shall in all respects handle, treat, deal with and manage any and all Hazardous Materials in, on, under or about the Project in total conformity with all applicable Environmental Laws and prudent industry practices regarding management of such Hazardous Materials and no Owner shall modify or alter any bio-swales within the Project.

(c) No Owner shall (i) install, use, employ or permit to be installed, used or employed, any underground storage tank in, on, about or under the Property except in compliance with all laws, including, without limitation, Environmental Laws, or (ii) conduct the "treatment," "storage," and/or "disposal" (as such terms are defined pursuant to 42 U.S.C. Section 6901 et. seq.) of any Hazardous Material in, on, under or about the Property, provided, however, than an Owner may, so long as such activities strictly comply with all applicable Environmental Laws applicable thereto (A) accumulate such Hazardous Materials as allowed under applicable Environmental Laws and regulations for off-site treatment, disposal and storage, and (B) use and store commercial products and raw materials on its Lot which may contain Hazardous Materials.

7.7 Payment of Taxes, Liens. Each Owner shall pay or cause to be paid prior to delinquency the Real Property Taxes and all other public, governmental, quasi-public or quasi-governmental charges which are or may become a lien upon such Owner's Lot(s) and Exclusive Use Areas benefiting said Owner (**"Impositions"**), and all other liens or charges which may be or become superior to this Declaration or any amendments thereto. Each Owner shall have the right, at its own cost and expense, and in its own name, to contest or protest or seek to have reviewed, reduced, equalized or abated any Imposition levied upon its Lot(s) by first paying such Imposition and thereafter filing a claim for refund or pursuing such other remedy as may then be available under and in accordance with California law. Upon final determination of any such proceeding, the protesting Owner shall pay the Imposition for which it is responsible pursuant to this Section as they are finally determined and all penalties, interest, costs and expense which may thereupon be due or have resulted therefrom.

7.8 Maintenance of Lots. Each Owner shall cause to be maintained and repaired in good order, condition and repair as provided in Section 9.1, the exterior of all Buildings, all Building Appurtenances and other structures, all exterior lighting, exterior signs, walks, driveways, lawns and landscaping and the drainage, irrigation and/or utility facilities or structures on such Owner's Building Lot (excepting any portion of a Building Lot which is maintained by the Operator as Common Areas). Each Owner of a Building Lot shall cause all graffiti, rubbish, debris and unsightly material and objects of any kind to be regularly removed and not allowed to accumulate on or in the areas and improvements referred to above within or adjacent to the Building Area on such Owner's Lot. The failure of any Owner to so maintain any such areas shall entitle the Operator to cure such default of such Owner pursuant to Section 9.5 hereof.

7.9 Outside Installations. No exterior radio antenna, "CB" antenna, television antenna, satellite dish, earth receiving station, or other antenna of any type shall be erected or maintained within the Property except as authorized by the City, the Committee, the FAA and any other governmental agencies with authority and jurisdiction over the Project. Declarant may grant easements for such purposes. All rooftop equipment (including without limitation satellite dishes, antennae and other communication devices, ventilators, HVAC components or solar panels) must be related to the operation of the business in the Improvements located on the Lot, and must be screened from public view within the Project, and from any streets adjacent to the Project in compliance with all applicable Laws. The Operator is hereby authorized to enforce the restrictions of this Section 7.9 by any reasonable means, including without limitation, removing any rooftop equipment in violation of this Section 7.9. The Owner of the Lot with the rooftop equipment in violation of this Section 7.9 shall pay all costs of the enforcement actions as a Reimbursement Assessment.

7.10 Prohibition of Outdoor Displays. Except with respect to Lots 12 and 14 and as otherwise expressly approved by the Committee or as otherwise permitted in a Supplemental Declaration, no Owner, or any guest, tenant or invitee of any Owner, shall store or display any item whatsoever anywhere on the Properties, except completely within the Owner's Building or other enclosure approved in accordance with Article 6 of this Declaration.

7.11 Leases. This Declaration is intended to be binding upon all lessees and tenants of any Lot, or portion thereof. To ensure the binding effect on tenants and lessees, each Owner agrees, by acceptance of the deed or ground lease by which such Owner acquired title or a leasehold interest in a Lot, not to rent or lease all or any portion of such Owner's Lot to any person, partnership, corporation, trust, or any other entity except pursuant to a written lease or rental agreement expressly referring to this Declaration pursuant to which (i) the lessee or tenant accepts the leasehold estate subject to this Declaration, and (ii) the lessee or tenant agrees to perform and comply with the restrictions herein or to permit entry and other actions by the lessor for the purpose of performing and complying with these restrictions.

7.12 Avigation Disclosure. "Notices of Airport in the Vicinity" are to be provided to all prospective tenants in the Project by all Owners of Buildings in the Project and Owners are to require in their leases that their tenants make their employees aware of such avigation disclosures. Notices are to indicate that the Project will be regularly over flown by a variety of aircraft at low altitudes on their approach to or departure from the Santa Barbara Municipal Airport and that associated with this are noise and increased risk of aircraft related accidents. Additionally, each Owner shall attach a copy of the Amendment of Avigation and Noise Easement dated 8/9/01 to each such tenant notice. Among other things, the Avigation and Noise Easement states that no significant quantities of hazardous materials such as flammables, toxic chemicals, and/or radioactive materials will be permitted in storage sheds in the RPZ, the RPZ being a specific area of the Avigation Easement on Lots 3, 8 and 11 of the Project that is planned for self storage buildings.

ARTICLE 8
COMMON AREA

8.1 **Use**. Subject to the provisions of this Article 8 and such other provisions of this Declaration regarding restrictions upon use, the Common Area Lots and Common Areas of each Building Lot, if any, shall be used solely for the purposes specified in this Article 8. In addition, no Owner or Occupant shall use or permit to be used the Common Area Lots or Common Areas of any Building Lot, if any, for any use other than the following:

(a) Parking motor vehicles, and pedestrian and vehicular ingress and egress by Occupants and their Permittees, to and from Buildings, the Common Parking Areas exclusive parking areas and adjacent public streets;

(b) Parking stalls, sidewalks, walls, ramps, driveways, lanes, curbs, gutters, seating areas, flagpoles, bike racks, kiosks, automatic teller machines, bus stops and similar facilities for accommodating public transportation, traffic control areas, signals, traffic islands, landscaped areas, traffic and parking lighting facilities and monument signs with appropriate underground electrical connections, and all things incidental thereto, all as approved by the Operator and only in locations approved by the Operator;

(c) Public utility installations serving Buildings or the Common Areas;

(d) Ingress and egress of delivery and service vehicles to and from the Project or any portion thereof and adjacent public streets, and parking thereof only in unloading and truck loading and unloading areas;

(e) Delivery of goods, wares, merchandise and providing services to Occupants of the Project;

(f) Perimeter walls and fences;

(g) If required by Law, recycling facilities or pickup points, the location of which are approved by the Operator; and

(h) Lighting standards, Common Landscaping, Common Lighting Facilities, Common Utility Lines, Common Water Lines, Common Parking, Common Signage, Common Drainage and Irrigation Facilities and any other Common Areas Improvements as may be required under applicable controls and regulations of the City, the GWD or any other governmental agencies. Owners Occupants of Building Lots (subject to approval by the Owner(s) of such Building Lots) may also install and maintain security and surveillance devices upon the Common Areas, if any, located within their respective Lots, subject to compliance with all terms of this Declaration related thereto; and

(i) Loading areas, trash enclosures, emergency generator equipment, telecommunications equipment or similar facilities or structures in the Common Areas serving the Occupants of one or more Buildings, subject to approval of the location and design by the Operator.

(j) Exclusive Use Areas and Exclusive Use Area Improvements to the extent approved by the Operator, including, without limitation, loading areas and trash enclosure areas.

The Common Areas shall be used reasonably for the foregoing purposes so as not to interfere with the parking to be available to satisfy all governmental requirements for parking for Buildings within the Project.

8.2 **Modification of Common Areas**. The anticipated overall design of the Common Parking Areas and pattern of traffic flow over the Common Areas within the Project is anticipated to be as shown on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**; provided, however, such Conceptual Site Plan reflects the Project at conceptual full build out and the Project may developed over time in multiple phases. Declarant reserves the right in the course of the development of the Project to alter the Conceptual Site Plan and to designate additional portions of the Project as Common Area Lots and/or to designate additional portions of Building Lots as Common Areas of the Project. The Operator shall have the right to relocate or reconfigure the Common Area Lots, Common Parking Areas and portions of any Building Lots designated as Common Areas provided that: (i) any direct costs incurred in connection with such relocation shall be paid by the Operator; (ii) the amount of parking available on the Property within reasonable proximity to a subject Lot shall not be less than that required by the City or pursuant to agreement between the Operator and any Owner affected by such relocation or reconfiguration; and (iii) no Lot shall be deprived of reasonable access for ingress and egress from the public streets abutting or within the Property to such Lot. Furthermore, subject to the limitations set forth in the previous sentence, nothing contained in this Declaration shall be deemed to prohibit Declarant or the Operator from: (a) readjusting the boundaries of any Lot which it owns; (b) making adjustments in the Allocated Parking Spaces; (c) creating new Building Lots within any Common Area Lots or creating or modifying Common Area Lots by subdividing or adjusting Lot lines of Building Lots; or (d) conveying any portion of a Common Area Lot, which portion may hereafter be re-subdivided as a separate legal Building Lot, to any Owner for development by such Owner, consistent with this Declaration, with a Building, Building Appurtenances and with on-site parking, walkways, driveways, and other Improvements which are not to be used in common with other Owners, after receiving appropriate approval to do so from the City.

8.3 **Parking.** The treatment of parking is addressed in Section 7.2.

8.4 **Construction and Repair.** All construction, alteration or repair work requiring workers to perform activity or to use or locate materials, tools or equipment (such as, but not limited to, compressors, sawhorses, tool boxes, scaffolds, ladders and barricades) in the Common Areas (other than Exclusive Use Areas) during the course of performing such work, whether such work is undertaken with respect to Building Improvements located on a Lot or in the Common Areas, shall be subject to the prior written approval of the Operator and shall be accomplished in the most expeditious and speedy manner consistent with ongoing business operations within the Project. The Owner or Occupant undertaking such work shall take all measures necessary to minimize any disruption or inconvenience caused by such work. Such work shall be accomplished by the Owner or Occupant undertaking it in a reasonable manner so that any damage or adverse effect which might be caused by such work to any other Owner or Occupant or to any Lot (including the Lot on which the work is being accomplished) is minimized. The Owner or Occupant undertaking such work shall repair at its own cost any and all damage caused by such work and shall restore the affected portion of any Lot (including the Lot upon which such work is performed) to a condition which is equal to or better than the condition which existed prior to the beginning of such work. In addition, the Owner or Occupant undertaking such work shall pay all costs and expenses associated therewith and shall indemnify, protect, defend and hold Declarant, the Operator, the Association and all other Owners and Occupants harmless from all liabilities, damages, losses, costs, expenses or claims arising out of, in connection with or attributable to the performance of such work. Except in cases of emergency, all such work shall be undertaken only after giving the Operator ten (10) days prior written notice of the work to be undertaken, the scope and nature of the work, the duration of the work and the area in which the work is to be performed. Notwithstanding the foregoing, construction, alteration or repair work to be accomplished outside the Common Areas (i.e., within a Building or Building Area on a Building Lot) may be made without the consent of or prior written notice to the Operator required under this Section.

8.5 **Lighting the Common Areas.** The provisions of this Section shall be subject to any resolution or resolutions to the contrary which may be adopted by the Operator from time to time. Common Area Lighting (other than lighting necessary for security of the Project or portions thereof) shall be turned on at least thirty (30) minutes before sunset (but not more than one (1) hour before sunset) and shall remain on each day until at least 11:00 p.m., unless to do so is contrary to any Law then in effect, in which event, the standard so prescribed shall be adhered to while in effect. Common Area Lighting representing not less than twenty-five percent (25%) of full intensity of the Common Area Lighting system, uniformly distributed throughout the Common Areas, shall remain on each day after 11:00 p.m. until dawn for security purposes, unless all of the Owners consent to a lesser amount of lighting in writing, or unless to do so is contrary to any Law then in effect, in which event, the standard so prescribed shall be adhered to while in effect. If "special" lighting (other than lighting necessary for security of the Project) is required or if regular lighting is required for a time later than the foregoing by any Owner or Occupant of the Project, then the electricity to service such lighting requirements shall, if reasonably feasible, be separately metered and all expenses thereof shall be paid by the Owner(s) or Occupant(s) who requires the special service. If such separate metering is not reasonably feasible, then the cost of such special lighting shall be determined and equitably prorated based on the amount of time required by each such Owner or Occupant and the Floor Area of each Owner or Occupant in relation to the Floor Area of all of the Owners or Occupants requiring the special service; all such prorated expenses shall be paid by the Owners or Occupants which require the special service.

8.6 **Obstructions Within Common Areas.** Except as otherwise expressly provided in this Declaration, no walls, fences, barriers or obstructions of any sort or kind shall be constructed or maintained in the Project, or any portion thereof, by any Owner, its agent or Occupant, which prevent or impair the use or exercise of any of the easements granted in Article 12 below, including, but not limited to, the ingress and egress of vehicular and pedestrian traffic and parking within and upon the Common Area Lots and other Common Areas including Common Parking Areas; provided, however, reasonable traffic controls (including speed bumps) as may be necessary to guide and control the orderly flow of traffic may be installed so long as access driveways to the Common Parking Area are not closed or blocked and the traffic circulation pattern of the Common Areas is not changed or affected in a substantial way; and provided further, temporary fences made of security chain link may be erected to cordon off areas of construction activity (including staging areas for equipment and materials).

8.7 **Signs.** Except for directional signs for guidance within the parking and driveway areas of the Common Area, freestanding Common Area monument signs at locations established by Declarant, and such other signs as may be required by Law (such as signs warning of hazardous substances), no sign shall be erected or maintained upon the Common Area which is not in conformance with the Sign Program (subject to such variances as may be granted by Declarant as provided in Section 8.7(b) below). Subject to the foregoing, each Owner shall have the right to erect, maintain and replace signs on the exterior of the Buildings located on its Lot, provided such signs shall be constructed so as to lie flat against such exterior fascia facing outward and shall not protrude more than two (2) feet from the surface thereof, and provided further, in no event shall signs be located on the roofs (excluding canopies so long as no sign is erected on a canopy which sign will extend above the height of the Building roof) of any Buildings in the Project without the prior written consent of the Committee. Except as expressly permitted herein, there shall be no signs in the Project without the prior written approval of the Committee.

(a) Without limiting the foregoing, no sign, poster, display, billboard or other advertising device of any kind shall be erected, hung, flown or otherwise displayed to the public view on any portion of the Properties, or on any public street abutting the Property, without the prior written consent of the Committee or unless otherwise permitted in a Supplemental Declaration, except (a) traffic and other Common Signs installed by Declarant as part of the original construction of the Property, or (b) signs, regardless of size, used by Declarant, its successors or assigns, to advertise the Property during the construction and sales period. All signs or billboards and the conditions promulgated for the regulation thereof shall conform to all Laws.

(b) If an Owner desires to vary from the Sign Program for the Owner's Lot to accommodate the needs of a particular Occupant(s) for exterior signs, the Owner shall, at the Owner's sole cost and expense, prepare or cause to be prepared the proposed variance from the Sign Program. The Owner shall submit the proposed variance to the Committee for the Committee's review and approval, which, to ensure aesthetic harmony and consistency within the Project, the Committee may withhold in the Committee's sole and absolute discretion. If the Committee approves the proposed variance from the Sign Program, such Owner shall be entitled to seek variance from the design criteria imposed by City and any other applicable governmental regulations or requirements governing exterior signs in the Project (collectively, **"Government Sign Restrictions"**) so that the Government Sign Restrictions will permit the Owner's proposed variance from the Sign Program. The Committee may, in its sole and absolute discretion, at such Owner's request and expense, reasonably cooperate with such Owner in seeking such variance from the Government Sign Restrictions.

(c) Declarant reserves the right to grant rights to Owners and/or Occupants (**"Sign Panel Users"**) to place identification sign panels (individually a **"Sign Panel"** and collectively **"Sign Panels"**) on multi-tenant monument signs constructed by Declarant or the Operator within the Project. Except as expressly granted by Declarant, no other Owner or Occupant shall have any rights to place any Sign Panels on any multi-tenant monument signs within the Project. All Sign Panels shall be maintained by the Sign Panel User to whom such Sign Panel(s) belong or by the Operator at the sole cost of the Sign Panel User to whom such Sign Panel(s) belong. Except as otherwise provided herein, each Sign Panel shall comply with the Sign Program.

(d) Each Sign Panel User shall be solely responsible for all costs to fabricate, obtain permits for and install its individual Sign Panels on the monument sign to which it has been granted rights hereunder. Each Sign Panel User shall maintain its Sign Panel(s) and all individual illuminating components serving such Sign Panel(s) in an attractive and good, clean and first-class state of order and repair, including the prompt replacement of broken, faded or damaged sign panels, the prompt replacement of burned-out or broken light bulbs and the prompt removal and repainting of graffiti. The sign easements granted in this Declaration include a right of entry for Sign Panel Users and their contractors to conduct sign panel installation, replacement and maintenance, provided such entry and work shall not interfere with the use of the monument sign by other Sign Panel Users or the use and enjoyment of the grantor Owner's Lot, by such Owner or its Occupants, and the Sign Panel User conducting such work shall promptly repair any damage to the monument sign or any other improvements (including landscaping) on the Lot on which the monument sign is located which is caused by such entry and work and shall indemnify, defend and hold the other Sign Panel Users and the Owner on whose Lot the monument sign is located harmless from and against any and all claims arising from such entry. If any Sign Panel User fails to properly repair and maintain its Sign Panel, and does not cure such failure within thirty (30) days following written demand to do so from the Operator or any other Sign Panel User or Owner, then the Operator may undertake and perform such maintenance, repair and/or the replacement of the Sign Panel in question. Any party undertaking such work may replace the Sign Panel with an appropriate-colored blank Sign Panel, in order to maintain the Sign Panel in first-class appearance as provided for above. The Sign Panel User which has failed to properly maintain its Sign Panel shall reimburse the party performing such curative work for all costs incurred to correct such failure, together with interest at the lesser of ten percent (10%) or the maximum legal rate.

(e) Each Sign Panel User hereunder (whether or not it has assigned its rights to an Occupant) shall pay its pro rata share of the costs reasonably incurred by the Operator to design, construct, install, illuminate, operate, repair, replace and maintain the Monument Sign, said payment to be made within thirty (30) days following receipt of each periodic billing from the Operator (to occur not more often than monthly).

8.8 **Operator Maintenance of Common Areas**. The Operator shall control, manage, maintain, repair, replace and restore (or cause to be managed, maintained, repaired, replaced and restored), the Common Area Lots and all Common Area Improvements situated thereon and all other Common Areas of the Project and all Improvements therein located upon any Building Lots (except any portion thereof which is an Exclusive Use Area unless the Owner entitled to use such Exclusive Use Area requests that Operator manage, maintain, repair and replace such Exclusive Use Areas solely at such Owner's expense payable to Operator as a Reimbursement Assessment) in a first-class condition and a good state of repair and appearance. The cost of maintenance for which the Operator is responsible under this Article 8 shall be assessed as part of the Regular Assessments for Common Expenses and Common Parking Expenses, as may be expressly provided otherwise herein. Operator's rights and duties with respect to the Common Areas shall include, without limitation:

(a) Operating, insuring, maintaining, repairing and replacing all paved surfaces of all Common Parking Areas so as to keep such areas in a level, smooth and evenly covered condition with the type of surfacing material originally installed or such substitute as shall in all respects be equal or superior in quality, use and durability and with periodic replacement striping of all parking spaces and including, sweeping and cleaning (including steam cleaning)of all Common Parking Areas, Common Area sidewalks and other Common Area hardscape, as necessary;

(b) Removing from the Common Area all papers, debris, filth and refuse, and thoroughly sweeping the area to the extent reasonably necessary to keep the area in a clean and orderly condition; provided, however, Owners and their Occupants shall be responsible for daily sweeping and cleaning of their Lots, including all Common Area located thereon, to keep their Lots clean and free and clear of trash, dust and debris;

(c) Operating, insuring, maintaining, repairing and replacing all Project Common Signage, where necessary;

(d) Operating, insuring, maintaining, repairing and replacing all artificial Common Lighting Facilities as reasonably required;

(e) Operating, insuring, maintaining, repairing and replacing all Common Area Landscaping including all automatic sprinkler systems and irrigation water lines;

(f) Operating, insuring, maintaining, repairing and replacing all Common Utility Facilities including all Common Water Lines, walls, common storm drains, utility lines, sewers and other facilities for utilities which are necessary for the operation of the Common Areas of the Project; and

(g) Maintaining free and unobstructed access to and from the Common Area Lots and all other adjoining portions of the Project and to and from the Common Area Lots and all streets abutting the Project as permitted by applicable Laws;

(h) Hiring and supervising private security, if any;

(i) Contracting with GWD or any replacement agency for water service to the Project; and

(j) The maintenance of the Common Areas in accordance with this Declaration, the Master Plan, the conditions of approval, and other applicable Laws.

The foregoing notwithstanding, the following exceptions shall apply:

(k) During the period of construction or repair of any Building on any Building Lot, the Owner of such Building Lot shall maintain (or cause to be maintained) those portions of the Common Areas within its Lot, if any, which are affected by such Building construction or repair and shall be responsible for controlling blowing dust and debris resulting from such construction or repair activity.

(l) With respect to those portions of facilities for water, sewer, gas, telephone, electricity and other utilities and any central plant facility serving only one Building and lying on or beneath the Common Areas (e.g., an electric trunk line from which individual lateral lines are routed to serve different individual Buildings), the Owner benefited by such facilities and not the Operator will perform any required maintenance, repair or replacement (or cause the same to be performed). If any such facilities including central plan facilities benefit more than one Building and Owner, the Operator may, upon agreement with such Owners maintain and repair such facilities, in which event the Operator will bill each Owner’s share of the cost of the work to the Owners of the Lots whose Buildings are served by such facilities. Each such Owner's share of the total bill shall be determined by multiplying the total bill by a fraction, the numerator of which is the Floor Area of the Building located on the Owner's Lot or Lots served by the facility, and the denominator of which is the Floor Area of all Buildings located on the Lots served by the facility.

8.9 Common Area Insurance.

(a) As part of its obligation to maintain the Common Areas within the Project except those portions designated as Exclusive Use Areas, the Operator shall at all times maintain in force and effect commercial general liability insurance insuring Declarant and, as additional insureds, the Association, the Board, the Committee, all Owners and Occupants who now or hereafter own or hold any Lot or any qualifying leasehold estate (*i.e*., qualifying the lessee thereunder to be treated as an Owner under this Declaration) and any third party property management company performing services for the Operator, if any, and any other party in interest identified by the Operator as their respective interests may appear (provided that the Operator is given prior written notice of such interest), against claims for bodily injury, personal injury, death or property damage occurring in, upon or about the Common Area Lots and other Common Areas of the Project. Such insurance shall be written with an insurer licensed to do business in the State of California. All such insurance shall be primary coverage, endorsed to name as additional insureds all Owners and Owner/Occupants under leases of which the Operator has been notified in writing, and shall not require that any other insurance be called upon to contribute to a loss under such coverage, and shall have liability limits of not less than Three Million Dollars ($3,000,000) combined single limit coverage for bodily injury, personal injury, death and/or property

damage arising out of any single occurrence, which amount shall be reviewed annually and changed to reflect the current practice in mixed use commercial centers in Santa Barbara County, California which are of a similar size and which have a similar mix of Occupants. The Operator shall cause certificates of insurance to be issued by the insurer to each of the Owners of whom the Operator has been notified in writing, certifying that such insurance is in full force and effect and shall not be canceled or materially amended without thirty (30) days prior written notice thereof to each of such Owners.

(b) The Operator shall also obtain and maintain in force property damage insurance under a standard form policy or policies of all-risk insurance then in use in California, covering all Common Parking Area parking surfaces and Improvements, Common Area retaining walls and other Common Area walls, Common Lighting facilities and lighting standards, Common Landscaping (in the reasonable business judgment of the Operator), sidewalks, walkways, driveways and other Improvements in the Common Areas (excluding Exclusive Use Areas); Worker's compensation insurance, as required by Law; Association Directors' and Officers' errors and omissions insurance, in form and amount determined by the Board; and insurance against any other risks which the Operator considers appropriate.

(c) Insurance premiums for all such insurance obtained by the Operator shall be Common Expenses. Operator shall use its commercially reasonable and diligent efforts to obtain an endorsement to all such policies naming as an "additional insured" any Owner, Mortgagee, or Permittee requesting such endorsement upon condition that such party pay to Operator the actual cost of such endorsement. If Operator makes a claim under any of the insurance policies on or relating to the Common Area described above, Operator shall obtain the funds required by the deductible of the applicable insurance policy by implementing a Special Assessment in the amount of such deductible. Funds to cover costs or expenditures of any uninsured loss relating to the Common Area shall be obtained by Operator by implementing a Special Assessment in the amount of such loss

8.10 **Negligent Owners.** Operator shall not be responsible for maintenance and repair of any portions of any Common Area Lot or other Common Area, the need for which arises out of or is caused by the willful or negligent act or neglect of an Owner, Occupant or other Permittee of a Lot, except to the extent covered by insurance carried by Operator and to the extent provided for in this Section 8.10. The repair or replacement of any portion of the Common Area resulting from such excluded events shall be the responsibility of the Owner (the "Negligent Owner") whose act or neglect, or whose Occupant(s) or Permittee(s), by act or neglect, occasioned such repair or replacement. If the Negligent Owner fails to make such repairs or replacements as provided in this Section 8.10 within fifteen (15) days from the date Operator notifies such Negligent Owner that such maintenance and repair is necessary including the reasons such Owner is responsible for such maintenance or repairs, Operator may make such repairs or replacements. If Operator makes such repairs or replacements, the cost thereof shall constitute Reimbursement Assessments chargeable to such Negligent Owner and shall be payable to Operator by the Negligent Owner within ten (10) days of demand. If, in Operator's reasonable judgment, the condition caused by such Negligent Owner or its Permittee(s) represents a dangerous condition or adversely affects the use, enjoyment, or appearance of the Common Area or of any other Lot, then Operator, or its authorized agent, may take immediate action, with or without notice to such Negligent Owner, to repair or remedy such condition and such Negligent Owner shall bear the entire cost of such repair or remedy as provided in this Section 8.10 and Section 8.11 below.

8.11 **Conveyance of Common Area Lots to Association.** Declarant may, from time to time hereunder, but is under no obligation to, convey any Common Area Lots and all Improvements located thereon to the Association.

8.12 **Assessment District; Dedication of Common Areas.** The Operator shall have the right to cooperate with governmental entities to establish a special assessment district for improvement or maintenance of all or any of the Common Area Lots and other Project Common Areas. Declarant or the Association shall have the right to dedicate or transfer, or grant an easement over, all or any portion of the Common Areas in which such party holds an interest to any public agency or authority or public or private utility, subject to such conditions.

8.13 **Destruction, Restoration.** As soon as practicable after the damage or destruction of all or any portion of any Common Area Lots or other Common Areas (excluding Exclusive Use Areas), the Operator shall: (a) obtain bids from at least two (2) reputable contractors, licensed in California, which bids shall set forth in detail the work required to repair, reconstruct and restore such damage or destroyed areas to substantially the same condition as existed prior to such damage and the itemized cost of such work; and (b) determine the amount of all insurance proceeds available to the Operator for the purpose of effecting such repair, reconstruction and restoration. If the insurance proceeds available to the Operator are sufficient to effect the total repair, reconstruction and restoration of the damaged or destroyed areas, then the Operator shall cause such to be repair, reconstructed and restored to substantially the same condition as existed prior to such damage. If the proceeds of insurance available to the Operator are insufficient to cover the cost of repair, reconstruction and restoration, the Operator shall levy a Special Assessment as provided in Section 2.6 for all additional funds needed to comply with the obligation of the Operator to repair, reconstruct, restore or maintain the Common Area Lots and other Common Areas in accordance with this Article 8, except that any limitations on the amount of a Special Assessment shall not apply.

ARTICLE 9
OWNER MAINTENANCE

9.1 Owners' Maintenance Obligations. Subject to Section 9.3, each Building Site Owner shall maintain, repair and replace (or cause to be maintained, repaired and replaced) the following:

(a) All exterior surfaces and roofs of Buildings and all Building Appurtenances and other structures located on such Owner's Lot(s), including, without limitation, all exterior walls, exterior signs, roofing materials, glass and painted surfaces, all such painted portions of Building exteriors to be repainted as frequently as is necessary to maintain them in first class condition with the same colors as such portions were originally painted or stained, unless the Committee approves a change in color, which approval may be withheld in the Committee's sole, absolute and unfettered discretion;

(b) All other portions of the Owner's Lot, unless designated as Common Areas, and all Exclusive Use Areas and Exclusive Use Area Improvements benefiting that Owner, whether located upon such Owner's Lot or elsewhere within the Project;, including, without limitation, all landscaping located on such Owner's Lot other than Common Landscaping.

(c) Any and all monument signs on which the name of an Occupant of the Owner's Lot appears, even if the monument sign is located on another Owner's Lot;

(d) Those portions of facilities for water, sewer, gas, telephone, heating, ventilation and air conditioning, electricity and other utilities, drainage and/or irrigation that are for the exclusive benefit of such Owners' Buildings, whether or not such facility or structure is located in Common Areas;.

9.2 Standards for Maintenance and Repairs. All Lots and Improvements to be maintained by the Owner thereof as provided in this Article shall be maintained and repaired by such Owner so as to maintain such Owner's Lot and Improvements in a in a neat, clean and first-class condition in accordance with the approved plans for such Lot and Improvements, the terms of this Declaration, all conditions of approval for the Project (including, without limitation, City Transportation Demand Management ["TDM Plan"] requirements) and all other applicable City standards and regulations, with all exterior areas and landscaping to be kept in a sightly, operational and well-kept condition, free and clear of weeds, debris and rubbish and so as to not interfere, interrupt or otherwise impair delivery of utilities required for maintenance of the Common Areas and by other Buildings within the Project Each Owner shall also adopt and maintain such standards of property maintenance, appearance and housekeeping as are consistent with this Article as respects such Owner's Occupants.

9.3 Trash Removal. Each Owner and or its Occupants shall also contract for the removal of trash from its Buildings.

9.4 Lateral Support. Each Owner shall maintain such Owner's Lot with sufficient landscaping and plantings so as to prevent any erosion upon such Owner's Lot which may result in damage to the Lot or to any adjacent Lot. No Owner shall perform any excavation upon such Owner's Lot that will result in damage to any adjacent Lot.

9.5 Closure. Each Owner of a Lot shall, following the permanent closure or cessation of any business operation which is expected to continue for any extended period of time, take such measures as may be reasonably required under the circumstances to prevent vandalism, including preventing graffiti and preventing windows from being broken, and to keep the vacant Building or premises in a reasonably attractive manner.

9.6 Repair or Replacement of Damaged Building. In the event of any damage to or destruction of any Building(s), Building Appurtenance(s) and/or any other Improvement(s) on a Lot, or any Exclusive Use Areas benefiting the Owner of such Lot, the Owner of such Lot shall, subject to the requirements and limitations stated in this Declaration and any Mortgage encumbering such Lot, (a) repair, restore and rebuild such Building(s), Building Appurtenance(s) and/or other Improvement(s) as quickly as reasonably practicable subject to the requirements and limitations stated in this Declaration; (b) tear down and remove all parts of said damaged or destroyed Building(s), Building Appurtenance(s) and/or other Improvement(s) then remaining and the debris resulting therefrom and otherwise clean and restore the area affected by such casualty to a level and clean condition; or (c) any combination of the above in a manner satisfactory to the Committee. The Owner of any Lot on which damaged Building(s), Building Appurtenance(s) and/or any other Improvement(s) are located shall be obligated to proceed with all due diligence hereunder, and such Owner shall cause cleanup and/or reconstruction to commence within three (3) months after the damage occurs and to be completed within twelve (12) months thereafter, unless prevented by causes beyond such Owner's reasonable control. Any damage or destruction to any Building(s), Building Appurtenance(s) or other Improvement(s) shall not affect the amount of assessments allocated to the Owner of the Lot upon which such Building(s), Building Appurtenance(s) and/or other Improvement(s) is (are) located as provided in Section 2.4 unless and until such time as the Building(s), Building Appurtenance(s) and/or other Improvement(s) is (are) restored and/or rebuilt and the Floor Area of the Building is recalculated as provided in Section 2.4.

9.7 Operator's Right to Repair Neglected Lots. If an Owner fails to maintain any Improvements or any other portions of such Owner's Lot (including Exclusive Use Areas) so as to violate any provisions of this Article 9, then the Operator shall have the right, through its agents, contractors and employees, to enter onto the Owner's Lot to repair, maintain and restore the Lot, any Exclusive Use Areas, and the exteriors of any Building(s), Building Appurtenances and other Improvements erected thereon. However, entry into a Building or Exclusive Use Area may be made only after not less than five (5) business days notice has been given to the Owner. Entry shall be made with as little inconvenience to the Owner and Occupants as possible and any damage caused thereby shall be repaired by the Operator at no cost to the Lot Owner or Occupant. The cost of such exterior maintenance shall be levied as a Reimbursement Assessment against such Lot pursuant to Section 2.8.

9.8 Owner's Right to contract with Operator to maintain Exclusive Use Areas. Notwithstanding the foregoing provisions of this Article 9, any Owner(s) may, with the written approval of the Operator, contract with the Operator for the Operator to maintain and repair such any of such Owner's(s') Exclusive Use Area(s) at such Owner's(s') sole cost and expense.

ARTICLE 10
EMINENT DOMAIN

If the whole or any part of the Project is taken by right of eminent domain or any similar authority of Law, the entire award for the value of the land and improvements so taken shall belong to the Owner(s) of the property so taken or to their Occupants, as their interest may appear, and no other Owner of land in the Project shall claim any portion of such award by virtue of any interest, easement or other right created by this Declaration; provided, however, any such other Owner may file a collateral claim with the condemning authority over and above the value of the land and improvements being so taken to the extent of any damage suffered by such Owner resulting from the severance of the area so taken, provided such collateral claim does not diminish the amount recoverable by the Owner(s) of the property so taken. In the event of a partial taking, the Owner(s) of the portion of the Project so condemned shall restore the remaining portion of the Project owned by such Owner(s), including improvements in the Common Areas, as nearly as possible to the condition existing just prior to such condemnation, without contribution from the Owners of the area not so taken and any condemnation award necessary therefor shall be held in trust and applied for such purpose; provided, however, that if any Mortgagee of any property in the Project makes the requirement pursuant to a provision in a Mortgage that the portion of the award representing compensation for severance damage to property not taken be paid to the Mortgagee, then the party required to make such payment to such Mortgagee shall not be obligated to restore the remaining portion of its Lot(s) so taken, except to the extent necessary to clear and pave for parking and/or landscape in accordance with plans approved by the Committee.

ARTICLE 11
MUTUAL RELEASE

Each Owner, for itself and, to the extent it is legally possible for it to do so, on behalf of its insurer, hereby releases the other Owners, Declarant, the Operator, the Association, the Board and the Committee from any liability for (a) any loss or damage to the property of each Owner located upon or in the Project, including Buildings and other improvements in the Project or the contents thereof caused by fire or other risks of the type generally covered by a standard policy insuring against "all risk" perils (also known as "special causes of loss"); and (b) any other direct or indirect loss or damage caused by fire or other risks, which loss or damage is of the type generally covered by a standard policy insuring against "all risk" perils (also known as "special causes of loss").

ARTICLE 12
EASEMENTS

12.1 Amendment to Modify or Eliminate Easements. This Declaration cannot be amended to modify or eliminate the easements reserved to the Operator, the Association or the Declarant or granted to any Owner(s) without prior written approval of the party(ies) benefited by such easement(s) (i.e., the Association, the Declarant or all Owner(s) benefited by such easements, as applicable) and any attempt to do so shall have no effect. Any attempt to modify or eliminate this Section shall likewise require the prior written approval of the Association.

12.2 Nature of Easements. Unless otherwise set forth herein, any easement reserved to the Association, the Operator, the Declarant or granted to any Owner(s) herein shall be nonexclusive. Easements granted or reserved herein shall include all easements shown on the Final Map and any and all future easements which may be granted or reserved after recordation of the Final Map (and therefore not shown on the Final Map) in accordance with the terms of this Declaration, may be evidenced by recordation of a Grant or Reservation of Easement or amendment to this Declaration recorded in the Official Records of the County.

12.3 Certain Rights and Easements Reserved to Declarant. The following rights and easements are hereby reserved to Declarant, may be exercised by Declarant so long as Declarant is the Owner of a Lot in the Project and shall automatically cease and terminate at such time as Declarant shall convey the last Lot in the Project to a third party:

(a) Easements for Repair and Maintenance. Easements for ingress, egress and access to and over all Common Area Lots and all Common Areas located upon any Building Lot for the maintenance and repair of all Common Parking Areas, Common Utility Lines, Common Water Lines, Common Landscaping, Common Lighting Facilities and Common Signage and other Improvements by the Association and/or the Operator in accordance with Articles 4 and 8 of this Declaration, together with the right to grant and transfer the same to contractors, subcontractors, agents and representatives of the Association and the Operator.

(b) Utilities. Easements over all portions of the Property for the installation of electric, telephone, cable television, water, gas, sanitary sewer lines and drainage facilities as are needed to service all portions of the Property and/or to further develop any undeveloped portions of the Property, together with the right to grant and transfer the same; provided, however, such easements shall not unreasonably interfere with the use and enjoyment by the Owners of their Lots with Buildings and parking in substantially the areas shown on the Conceptual Site Plans attached hereto as **Exhibits "B-1"** and **"B-2"**.

(c) Construction and Sales. Easements over all portions of the Property for the purpose of grading and installation of utilities, landscaping, irrigation and drainage facilities, and other Improvements, including without limitation, all Common Parking Areas and, on an interim basis prior to the commencement of construction of a Building upon any Building Lot, as necessary or appropriate to complete the improvement of the Common Areas as contemplated by the Conceptual Site Plans as the same may be amended from time to time and for the maintenance of all such Improvements, for the temporary storage of materials and equipment during the course of construction or maintenance, for display, sales and exhibit purposes in connection with the improvement and sale or lease of Lots within the Property (including without limitation in connection with the construction of additional Buildings, additional or modified Parking Areas and other Improvements), together with the right to grant and transfer the same to Owners, contractors, subcontractors, sales agents and representatives and prospective purchasers of Lots; provided, however, the exercise of such easement rights shall not unreasonably interfere with the use and enjoyment by the Owners of their Lots with Buildings and parking in substantially the areas shown on the Conceptual Site Plans attached hereto as **Exhibits "B-1"** and **"B-2".**

(d) Monument Sign(s). Easements for the installation of monument sign(s) identifying the Project within the Property as from time to time approved by Declarant or the Association.

(e) Drainage. Easements for drainage over the Property through the drainage patterns and systems established by Declarant from time to time upon the Property, together with the right to grant and transfer the same to Owners.

(f) Exclusive Use Areas. Easements over, under and across portions of the Property for the location, operation, maintenance, repair and replacement of Exclusive Use Areas and Exclusive Use Area Improvements in accordance with the terms of this Declaration; provided, however, the exercise of such easement rights shall not unreasonably interfere with the use and enjoyment by the Owners of their Lots with Buildings and parking in substantially the areas shown on the Conceptual Site Plans attached hereto as **Exhibits "B-1"** and **"B-2".**

(g) Easements for Public Agency Ingress and Egress. Easements over the Property and the right to grant the same to the City and/or any public or private agency, sufficient to guarantee access and entry to the Property and any Improvements thereon for any authorized fire inspector, building official, or any other official charged with carrying out the Laws of the City or any other governmental entity including, without limitation, a non-exclusive easement for public emergency vehicles and personnel acting in a public emergency over all portions of the Common Areas and each Owner's Lot designed for vehicular or pedestrian traffic.

(h) Additional Easements. Such additional easements over the Property as Declarant shall deem necessary and appropriate in its reasonable discretion in the course of developing, operating and selling Lots in the Project; provided, however, the exercise of such easement rights shall not unreasonably interfere with the use and enjoyment by the Owners of their Lots with Buildings and parking in substantially the areas shown on the Conceptual Site Plans attached hereto as **Exhibits "B-l"** and **"B-2".**

12.4 Certain Rights and Easements Reserved to the Association and the Operator. The following rights and easements are hereby reserved to the Association and the Operator:

(a) Easements for Repair and Maintenance. Easements for ingress, egress and access to and over all Common Area Lots and all Common Areas located upon any Building Lot for the maintenance and repair of all Common Parking Areas, Common Utility Lines, Common Water Lines, Common Landscaping, Common Lighting Facilities and Common Signage and other Improvements by the Association and/or the Operator in accordance with Article 4 of this Declaration, together with the right to grant and transfer the same to contractors, subcontractors, agents and representatives of the Association and the Operator.

(b) Easements for Public Agency Ingress and Egress. Easements over the Property and the right to grant the same to the City and/or any public or private agency sufficient to guarantee access and entry to the Property and any Improvements thereon for any authorized fire inspector, building official, or any other official charged with carrying out the Laws of the City or any other governmental entity including, without limitation, a non-exclusive easement for public emergency vehicles and personnel acting in a public emergency and easements as necessary to implement the Solid Waste Management Plan described in Section 26.3 (d), over all portions of the Common Areas and each Owner's Lot designed for vehicular or pedestrian traffic.

(c) Easements for Monument Sign(s). Easements for the continued placement and maintenance and repair of all monument sign(s) identifying the Project, together with the right to grant and transfer the same to contractors, subcontractors, agents and representatives of the Association and the Operator.

(d) Exclusive Use Areas. Easements over portions of the Property for the location, operation, maintenance, repair and replacement of Exclusive Use Areas and Exclusive Use Area Improvements, including, without limitation, Private Water Lines, in accordance with the terms of this Declaration; provided, however, the exercise of such easement rights shall not unreasonably interfere with the use and enjoyment by the Owners of their Lots with Buildings and parking in substantially the areas shown on the Conceptual Site Plans attached hereto as **Exhibits "B-1"** and **"B-2".**

12.5 Certain Easements for Owners. In addition to all other easements granted to Owners as provided in this Article 12, the following easements are hereby granted to each Owner of a Lot in the Project for the benefit of such Owners and their respective Occupants and/or Permittees to the extent such easement rights are granted by such Owners to their respective Occupants and/or Permittees:

(a) Utilities. Wherever sanitary sewer line connections, chilled water supply lines, chilled water return lines, water line connections, electricity, gas, telephone, communication and cable television lines or drainage facilities are installed within the Common Area Lots or the Common Area portions of any Building Lot, the Owners of any Lots served by said connections, lines or facilities shall have the right to, and there is hereby reserved to Declarant, together with the right to grant and transfer the same to Owners, easements over each Owner's Lot to the full extent necessary for the full use and enjoyment of such portion of such connections which service such Lot, and to enter upon any Lots owned by any other Owner, or to have utility companies enter upon the Lots, in or upon which said connections, lines or facilities, or any portion thereof are situated, to repair, replace and generally maintain said connections as and when the same may be necessary as set forth below, provided that such Owner or utility company shall promptly repair any damage to a Lot caused by such entry as promptly as possible after completion of work thereon. The Declarant (or the Operator where there no longer is a Declarant) shall have the authority to grant additional easements or rights-of-way for utilities over the Common Areas as necessary to serve the Common Areas and/or the Lots. Any such easements shall be subject to review, approval and execution by the Owners of such portions of the Lots affected by any such easements, such approvals not to be unreasonably withheld or delayed. The Owner of any Lot and any of his Occupants or licensees shall have the right at all reasonable times to enter upon the land subject to said easements and to install, maintain, operate, repair and service utilities and drainage facilities thereon for the use and benefit of his Lot; provided, however, any such Person shall restore said land, at his own expense, as nearly as practicable, to the same condition as existed prior to such entry and shall comply with the provisions of Section 12.12. The Owner of any Lot shall have the right to assign the benefit and use of any such easement to any public or private utility company, agency or district for the purpose of installing, operating, repairing, servicing and maintaining utilities or drainage facilities and enforcing the easement rights. For purposes hereof, "utilities" shall include electricity, gas mains and lines, water distribution lines, storm water sewers, sanitary sewers, telephone, fiberoptic, cable TV, and telegraph cables and lines, and other similar or related facilities commonly regarded as utilities. All storm drains, utility lines, transformers and meters shall be maintained under the terms of this Declaration in a safe and good working condition by the party responsible therefor. No grantee of a utility easement shall in the use, construction, reconstruction, operation, maintenance or repair of any storm drains, utility lines, transformers and meters in any way interfere, obstruct or delay the business of any Owner or Occupant, or the public access to and from said business or interfere, obstruct or delay in any way the receiving of merchandise by any Owner or Occupant. Without limiting the foregoing, wherever chilled water supply lines, chilled water return lines, sanitary sewer lines, water service lines, electricity, gas, telephone, cable television and data cable lines and conduits, storm drain facilities and related connections, facilities and other utilities (collectively, the "Utilities") are installed on and under the Property, each Owner of any Lot served by any Utilities (a "Served Owner") and each public or

private utility company, sanitation district or other governmental authority that is now or may hereafter become responsible for the maintenance of any Utilities on the Served Owner's Lot (collectively, the "Responsible Utility Companies") shall have the right, and there is hereby granted to each Served Owner and each Responsible Utility Company by each Owner of a Lot (a "Burdened Lot") on which are located any Utilities serving such Served Owner's Lot, a nonexclusive easement on, over, under and across all portions of the Burdened Lot on which are located Utilities for the purpose of inspecting, repairing, maintaining, replacing and reconstructing such Utilities when and as necessary, together with the right to enter upon the Burdened Lot to the extent and for such period of time as may be necessary to permit the exercise of the foregoing right and easement; provided, however, that (i) with respect to any Utilities that the Association is required to maintain, the Association, and not the Served Owner, shall be entitled to exercise right and easement hereby granted to the Served Owner; (ii) any Person that proposes to enter upon a Burdened Lot for the purpose of exercising the rights and easements hereby granted shall first give not less than forty-eight (48) hours' prior written notice of the proposed entry to the Owner of the Burdened Lot and shall further coordinate and manage such entry and any related maintenance, repair or construction work with the Owner of the Burdened Lot in such a manner as to minimize any resulting inconvenience to the occupants of the Burdened Lot; however, such written notice shall be waived when entry is required under emergency circumstances; (iii) the Owner, of the Burdened Lot shall have the right, at its sole expense, in cooperation with any applicable Responsible Utility Company and at no cost or expense to the Served Owner, to relocate any Utilities on the Burdened Lot to another location on the Burdened Lot that is feasible from an engineering standpoint, to the extent that such relocation is necessary to permit the construction of new structures or the expansion of existing structures on the Burdened Lot; and (iv) any Person exercising the right and easement hereby granted shall, at its sole expense, promptly repair any and all resulting damage to the Burdened Lot or the-Improvements and landscaping on the Burdened Lot (including without limitation any damage to other Utilities). In the event of any relocation of Utilities on a Burdened Lot, (i) the easement hereby granted shall automatically be deemed to apply to the Utilities as relocated, without the necessity of any instrument being delivered or recorded, and (ii) at the request of the Served Owner, the Owner of the Burdened Lot and the Served Owner shall execute, acknowledge and cause to be recorded an instrument in form and content reasonably satisfactory to the Served Owner for the purpose of confirming the relocation of the easement hereby granted without limiting the generality of the foregoing provisions, each Served Owner, by accepting title to such Served Owner's Lot, hereby agrees to indemnify and hold harmless the owner of the Burdened Lot on which are located any utilities serving such Served Owner's Lot from and against any and all claims, demands, liabilities, losses, obligations, causes of action, judgments, damages, costs and expenses of any nature that the Owner of the Burdened Lot may incur or suffer in connection with the exercise by the Served Owner or its authorized representatives of the easement granted in this Section 12.5(a).

(i) Notwithstanding anything to the contrary contained herein, it is understood that neither GWD nor any replacement water service provider shall have any responsibility for any Common Water Lines or Private Water Lines within the Project beyond the "customer side" of the two (2) main water meters providing water service to the Project unless and until such time as GWD or such replacement water service agency shall install water lines elsewhere within the Project.

(b) Drainage. There is hereby reserved to each Owner, easements for drainage over the Property through the drainage patterns and systems established by Declarant from time to time upon the Property.

(c) Exclusive Use Areas. As to each Owner which is granted the right to use any Exclusive Use Area(s) by Declarant, the Association or the Operator, together with the right to place and use Exclusive Use Area Improvements within any such Exclusive Use Area(s), there is hereby granted to each such Owner, easements in, over, under and across such Common Area portions of the Property as are reasonably necessary for the location, operation, use, maintenance, repair and replacement of, and access to, such Exclusive Use Areas and Exclusive Use Area Improvements as granted or approved by Declarant, the Association and/or the Operator for such Owner's exclusive use in accordance with the terms of this Declaration; provided, however, the exercise of such easement rights shall not unreasonably interfere with the use and enjoyment by the other Owners of their Lots with Buildings and parking in substantially the areas shown on the Conceptual Site Plan attached hereto as **Exhibits "B-2"**.

(d) Encroachments. Declarant hereby grants to all Owners for the benefit of each Lot the following mutual reciprocal perpetual easements for the purpose of providing subjacent or sublateral support for underground building footings, foundations and similar encroachments or intrusions ("Encroachments"):

(i) Upon any Lot for the benefit of any other adjoining Lot as a result of minor errors during the course of construction of any Improvements thereon, so long as any such Encroachment does not materially and adversely affect the reasonable use and development of any Lot being encroached upon or any Common Area Improvements thereon and is constructed pursuant to plans and specifications approved as provided in Article 6; or

(ii) Upon any Lot for the benefit of any adjoining Lot as a result of minor settlement, shifting or movement of a building on such adjoining Lot following any such intrusion.

In the event of any such Encroachment, the Owner of such encroaching Improvement (other than Declarant) may be required by the Operator to prepare and process a Lot line adjustment at the cost of such encroaching Owner. Except as to portions of the easement areas described above which are actually occupied by any Encroachment from time to time, such easements shall be non-exclusive and may be used for the installation of utilities or other facilities or any surface uses which do not unreasonably interfere with the use thereof for any Encroachment described above.

(e) Easements Appurtenant. All easements granted herein to Owners shall be appurtenant to and shall pass with title to each such Owner's Lot and may be used by the Owners and Occupants of each such Owner's Lot, and their respective Permittees, subject to any restrictions set forth in this Declaration.

12.6 General Easements

(a) Easements for Parking. There is hereby reserved to Declarant, the Operator and the Association together with the right and obligation to grant same to each Owner and each Owner's Occupants and Permittees for the benefit of each such Owner's Lot, a perpetual non-exclusive easement for "Parking" with respect to all Common Parking Areas of the Project; provided, however, (i) each Owner and its Occupants and Permittees (including visitors) shall have the right to use up to and no more than the total Allocated Parking Spaces for such Owner's Lot as set forth in Article 27 of this Declaration, (ii) subject to prior written approval of Declarant or the Operator, as applicable, each Owner shall have the right to designate for the exclusive use of such Owner and its Occupants and Permittees out of its total Allocated Parking Spaces, up to five percent (5%) of its Allocated Parking Spaces as Reserved Parking Spaces as set forth in Section 7.2; and (iii) all Parking by all Owners, Occupants and Permittees shall be subject to the terms of this Declaration. Each future Owner of a Common Area Lot, by taking title to its Lot subject to this Declaration, shall be deemed to have granted such easements on its Lot to all other Owners, Occupants and Permittees and each Owner of a Building Lot by taking title to its Lot subject to this Declaration, shall be deemed to have granted such easements on its Lot to all other Owners, Occupants and Permittees for interim Common Parking as may from time to time be established by the Operator upon such Owner's Building Lot prior to the commencement of construction of a Building upon such Owner's Building Lot. Notwithstanding the foregoing, it is intended that Occupants and Permittees of each Building will utilize Common Parking Areas most proximate to their Building and the non-exclusive parking easements granted and created by this Declaration shall not be deemed to create easements in favor of all Owners, Occupants and Permittees to park anywhere in the Project, rather such rights shall pertain to the Common Parking Areas most proximate to the Building owned or occupied by such Owner and the Occupants and Permittees of such Building as reasonably necessary to satisfy the requirement for Allocated Parking Spaces for each Building in the Project.

(b) Additional Easements for Parking. There is also hereby reserved to Declarant, the Operator and the Association together with the right to grant same to third parties including parties who are not Owners or Occupants of the Project, easements over non-exclusive Common Parking Areas for parking after normal business hours of the Project, together with the right to grant to third parties easements and licenses for parking within such non-exclusive Common Parking Areas during non-business hours, i.e., before 8:00 a.m. and after 6:00 p.m. Mondays through Fridays, and at all times on Saturdays, Sundays and holidays, provided all parking rights granted to Owners, Occupants and Permittees of the Project after 8:00 a.m. and before 6:00 p.m., Mondays through Fridays, are not materially impaired. The term "Parking" as used herein shall mean and be deemed to include and permit the following:

(i) The parking of passenger vehicles, and the pedestrian and vehicular traffic, of any of the Owners and their Occupants and Permittees;

(ii) The ingress and egress of all Owners, Occupants and Permittees, and the vehicles thereof, to any and from any portion of the Parking Areas and the public streets adjacent to the Parking Areas; and

(iii) The movement of pedestrians and vehicles by Owners, Occupants and Permittees between mercantile, business and professional establishments and occupants located or to be located within the Property.

(c) Easements for Ingress and Egress. Declarant reserves for itself, the Operator and the Association, together with the right and obligation to grant and transfer to each Owner, for the benefit of each Lot, a perpetual nonexclusive easement on, over and through all driveways, drive-aisles and paved areas of the Property including parking spaces (other than Reserved Parking Spaces) for vehicular and pedestrian access, ingress and egress by all Owners, Occupants and Permittees from public and private streets over and through the designated pedestrian and vehicular traffic circulation patterns and parking areas as may be established by Declarant from time to time upon the Common Areas Lots and any Common Area located upon any Building Lot for those purposes, including without limitation, over all such areas as are depicted on the Final Map; provided, however, Declarant shall not be entitled to re-designate or establish new pedestrian or vehicular traffic circulation patterns on Building

Lots that have been conveyed to an Owner without such Owner's prior written approval. Each future Owner, by taking title to its Lot subject to this Declaration, shall be deemed to have granted such easements over and across such portions of such Owner's Lot to all other Owners, Occupants and Permittees. Such easement rights shall be subject to the following reservations as well as other provisions contained in this Declaration:

(i) Except for situations specifically provided for in the following subparagraphs, no fence or other barrier which would unreasonably prevent or obstruct the passage of pedestrian or vehicular travel for the purposes herein permitted shall be erected or permitted within or across any driveway or parking areas of the Project.

(ii) In connection with any construction, reconstruction, repair or maintenance on its Lot, each Owner shall locate any temporary staging and/or storage areas on its Lot at such locations as will not unreasonably interfere with any driveway area or any access between such Lot and the other areas of the Property and the public and private streets or roadways adjacent to the Property.

(d) Easements for Construction and Repair. In addition to easements for encroachment granted to Owners as provided in Section 12.5(d) above, and in connection with any work performed upon a Lot, incidental encroachments into or upon the Common Areas within that Lot shall be permitted in connection with the use of ladders, scaffolding, storefront barricades and similar facilities resulting in temporary obstruction of portions of the Common Areas, all of which are permitted under this Section so long as their use is kept within reasonable requirements of construction work expeditiously pursued. The Common Areas may be used for ingress and egress of vehicles transporting construction materials, equipment and Persons employed in connection with any work provided for in this Declaration. The Common Areas within the Lot upon which the construction is taking place may also be used for temporary storage of material and vehicles being used in connection with such construction, subject to all of the other terms of this Declaration. Reasonable precautions and measures shall be taken so that any disturbance to the use of the Common Areas generated by such encroachments will be minimized.

(e) Right of Entry by Declarant, Association, Operator. Declarant, the Association, the Operator, and their employees, agents, and contractors are hereby granted the right to enter upon the Common Areas and upon any other portion of the Project, to the extent reasonably necessary, to repair, improve, maintain and operate the Common Areas and to exercise the rights and to perform the duties imposed by this Declaration on the Operator or the Association. Such right of entry upon portions of the Project other than the Common Areas shall be exercised so as to interfere as little as reasonably possible with the possession, use and enjoyment of the Owner or Occupants of such portion and shall be subject to the provisions of Section 7.4. The Association shall indemnify, protect, hold harmless and defend the Owner and Occupants of each Lot over which the foregoing easements are reserved from and against all liabilities, losses, liens, damages, claims, costs and expenses and arising from or caused by the use of such Common Areas by the Declarant, Association, and Operator.

(f) Common Area Entry by Owners. In connection with any entry by an Owner onto any Common Areas for purposes of exercising such Owner's rights pursuant to utility or drainage easements granted pursuant to this Article, or for purposes of accessing or performing any work with respect to any of such Owner's Exclusive Use Area(s) located upon the Common Areas as permitted under this Declaration or otherwise approved by the Operator, such Owner shall, at its expense:

(i) Maintain, at all times during such period of entry, commercial general liability insurance with a combined single limit per occurrence of at least $2,000,000, naming the Operator and the Association (and the Owner and Occupants of such Common Areas if not owned by the entering Owner) as additional insureds, and providing that such coverage shall not be terminated or modified without at least thirty (30) days' prior written notice to the Operator;

(ii) Deliver to the Operator a certificate evidencing that such insurance is in full force and effect prior to entry onto such Common Areas;

(iii) Perform all work in a safe manner, insure that no hazardous condition remains on such Common Areas, and repair any damage thereto;

(iv) Keep such Common Areas free and clear of all mechanics' or materialmen's liens arising out of such Owner's activities;

(v) Comply with all applicable Laws in connection with such work; and

(vi) Indemnify, protect, hold harmless and defend the Association, the Operator and the Owner and Occupants of such Common Areas from and against all liabilities, losses, liens, claims, damages, costs and expenses (including attorneys' fees and court costs) for labor or services performed or materials furnished to or for such Owner, or for personal injury, death or property damage, arising out of or related to such Owner's entry or breach of the provisions of this Section 12.6.

12.7 **Easements by Owner.** Upon the reasonable request of Declarant or the Operator, an Owner shall grant to the Declarant or the Operator such additional easements over such Owner's Lot(s) as may be reasonably requested for the benefit of one or more other Lots or the Common Areas provided, and upon condition that, the grant of such additional easement does not materially interfere or impede such Owner's use of its Lot(s).

12.8 **Easements Reserved and Granted.** Any easements referred to in this Declaration shall be deemed reserved or granted, or both reserved and granted, as applicable, notwithstanding that a deed to any Lot fails to reference this Declaration or such reservation or grant.

12.9 **Reservation by Declarant.** Declarant hereby reserves the right to subsequently grant and create any additional easements over one or more of the Lots owned by Declarant, including the Common Areas contained therein, for the benefit of one or more other Lots owned by Declarant, provided, and upon condition that, the grant of any such additional easements shall not materially interfere with or impede with the grant and use of the other easements established hereunder.

ARTICLE 13
APPROVAL OF OWNERS AND NOTICES

All notices, demands or requests for consent or approval of any kind which the Operator or any Owner or Occupant is required or desires to give or make upon Declarant, the Operator, the Association or any other Owner or Occupant shall (a) be in writing; (b) specify the Section of this Declaration which requires or authorizes that such notice be given or requires that such consent or approval be obtained; and (c) be given or made by personal delivery, private express courier, or by United States registered or certified mail, return receipt requested, postage prepaid, addressed as follows: If intended for an Owner, to the last known address of the Owner. If to Declarant, to CABRILLO BUSINESS PARK c/o SARES Regis Group, 500 Esplanade, Suite 470, Oxnard, CA 93030, Attention: Cabrillo Business Park Manager. The address for the Association and the Board shall be established by Declarant upon formation of the Association. Mailing addresses may be changed at any time upon written notification to the Operator.

When given in the manner prescribed in this Section, all notices, demands or requests for consent or approval shall be deemed given, received, made or communicated on the date personal delivery is effected or, if mailed, on the delivery date or the date on which delivery is refused by the addressee.

ARTICLE 14
AMENDMENTS

Until. such time as there is an Owner of any portion of the Property other than Declarant or an Affiliate of Declarant, this Declaration may be amended and such amendment shall be effective when executed by Declarant and recorded in the Official Records of Santa Barbara County. From and after the date that, but only so long as there is an Owner of any portion of the Property other than Declarant or an Affiliate of Declarant, this Declaration may not be terminated, extended, amended or restated in any respect whatsoever, or rescinded, in whole or in part, except by written instrument duly recorded in the Office of the County Recorder of Santa Barbara County (**"Supplemental Declaration"**), after first being duly signed and acknowledged by those Owners (which may include Declarant) holding at least seventy-five percent (75%) of the Members' voting power. Notwithstanding the foregoing, any termination, amendment, restatement, modification or rescission of any of the provisions of Sections 5.1, 5.5, 6.1, 6.8, 7.2(a), 7.5, 11.1, 11.7, 11.8 and this Article 14 shall require the prior written consent of the City. Notwithstanding the foregoing, this amendment provision shall not be amended either (i) to allow amendments to the Declaration by the assent or vote of less than seventy-five percent (75%) in voting interest of all Owners, or (ii) to deprive Declarant of any rights or powers granted to it hereunder. In addition, this Declaration cannot be amended to modify or eliminate the easements reserved to Declarant or granted to the Operator or the Association without the prior written approval of Declarant, the Operator or the Association, respectively. This Declaration shall not be amended in a manner that would materially and adversely affect one Owner's interest in its Lot, Building or the Project for the benefit of any other Owner(s), without the prior written consent of the Owner who is adversely affected. So long as Declarant is the

Owner of any undeveloped portion of the Property, it shall have the right to modify, amend, expand or terminate this Declaration with respect to such undeveloped portion other than any Common Area Lot, including the right to modify the use or regulations to which said portion shall be subject or to remove such undeveloped portion from this Declaration altogether. Property shall be deemed "undeveloped" if no permanent Improvements have been constructed thereon. Landscaping and surface parking areas shall not be deemed to be "permanent Improvements." Any amendment which affects or purports to defeat or render invalid the lien of any Mortgage made in good faith and for value, to be effective, must be approved in writing by the record holders of all such Mortgages encumbering the affected portions of the Property at the time of such amendment.

ARTICLE 15
NOT A PUBLIC DEDICATION

Nothing contained in this Declaration shall be deemed to be a gift or dedication of any portion of the Project to the general public or for the benefit of the general public or for any public purposes whatsoever, it being the intent of Declarant that this Declaration shall be strictly limited to and for the purposes expressed in this Declaration. The right of the public or any Person to make any use whatsoever of the Project or any portion thereof (other than any use expressly allowed by a written or recorded map, agreement, deed or dedication) is by permission and subject to control of the Owners.

ARTICLE 16
INJUNCTIVE RELIEF

In the event of any violation or threatened violation by any Owner or Occupant of any portion of the Project of any of the terms, covenants, conditions and obligations of this Declaration, in addition to the other remedies for which this Declaration provides, Declarant, the Operator, the Association and any or all of the other Owners shall have the right to enjoin such violation or threatened violation in a court of competent jurisdiction.

ARTICLE 17
BREACH SHALL NOT PERMIT TERMINATION

No breach of this Declaration shall entitle any Owner to cancel, rescind or otherwise terminate this Declaration, but such limitation shall not affect in any manner any other rights or remedies which such Owner may have under this Declaration by reason of any breach of this Declaration. Any breach of any of the covenants, conditions or restrictions set forth in this Declaration, however, shall not defeat or render invalid the lien of any Mortgage made in good faith and for value, but such covenants, conditions or restrictions shall be binding upon and be effective against such Owner of any of said property or any portion thereof whose title thereto is acquired by foreclosure, trustee's sale or otherwise.

ARTICLE 18
INDEMNITY/INSURANCE BY OWNERS

18.1 **Owner Indemnity.** Each Owner shall indemnify, protect, defend and hold harmless, Declarant, the Association, the Board and the other Owners from and against all claims, expenses, liabilities, loss, damage and costs, including any actions or proceedings in connection therewith and including reasonable attorneys' fees and costs, incurred in connection with, arising from, due to or as a result of the death of or any accident, injury, loss or damage, howsoever caused, to any Person or loss or damage to the property of any Person as shall occur on the indemnifying Owner's Lot (excluding Common Areas) including, without limitation, violation of any Environmental Laws, or the failure by an Owner to comply with the provisions of Section 7.6 regarding Hazardous Materials and compliance with Environmental Laws, except claims resulting from the negligence or willful act or omission of (a) the Association or the indemnified Owner, whichever is applicable; (b) any Occupant of the indemnified Owner's Lot (including such Occupant's agents, servants and employees); or (c) the agent, servants or employees of such indemnified Owner, wherever such negligence or willful act or omission may occur. In addition, to the fullest extent permitted by Law, neither Declarant, the Association, the members of the Board nor any of their respective agents, employees, successors or assigns shall be liable to any Owner for any damage, loss or prejudice suffered or claimed on account of any decision, approval or disapproval of plans and specifications (whether or not defective), course of action, act, omission, error, negligence or the like made in good faith and reasonably believed to be within the scope of their respective duties.

18.2 **Owner Insurance.** Each Owner shall at all times during the term of this Declaration maintain or cause to be maintained commercial general liability insurance covering the Owner's Lot and Exclusive Use Areas benefiting that Owner (excluding Common Areas) insuring against the risks of bodily injury, property damage and personal injury liability, with a limit of not less than Three Million Dollars ($3,000,000) per occurrence, which amount shall be reviewed and adjusted by the Operator every three (3) years for increases recommended by insurance industry-recommended standards for comparable mixed-use office/retail complexes in Santa Barbara County, California. Each Owner shall maintain property insurance, insuring all Buildings, Building Appurtenances and other structures on its Lot and Exclusive Use Areas (other than Common Areas) benefiting that Owner and personal property located therein from and against lose or damage by fire and/or casualty, under the standard form of all-risk insurance then in use in the State of California or under such other insurance as may be required under the terms of any Mortgagee encumbering the Lot.

ARTICLE 19
SEVERABILITY

If any provision of this Declaration is held by a court of competent jurisdiction to be invalid, the invalidity of such provision shall not affect the validity of the remaining provisions of this Declaration, and all remaining provisions shall continue unimpaired, in full force and effect.

ARTICLE 20
ENFORCEMENT AND REMEDIES

20.1 **Right to Enforce.** Declarant or the Association, as Operator, shall have the right to enforce, by all appropriate legal and equitable proceedings, all conditions, covenants, restrictions, reservations, liens, and charges now or hereafter imposed by the provisions of this Declaration. It is hereby agreed that money damages are an inadequate remedy for breach of any of the conditions, covenants and restrictions contained herein, other than a default in the payment of any assessment when due. Every Owner and Occupant of a Lot subject to these restrictions expressly waives the benefit of California Code of Civil Procedure Section 731(a) and any other comparable statute or rule, and agrees that such violation or breach may be enjoined whether or not monetary damages may be provided or provable. Prior to commencing litigation, the requirements of California Civil Code Section 1354 relating to alternative dispute resolution shall be satisfied.

20.2 **Owner's Remedies.** After written request to the Operator to prevent any violation of, or remedy any failure to timely perform, any responsibility or obligation under this Declaration by the Operator, Declarant, the Association, the Committee or any other Owner or Occupant, and failure by the Operator, Declarant or the Association within thirty (30) days after receipt of such request to diligently investigate the matter and undertake to remedy or otherwise address such matter, any Owner shall additionally have all enforcement rights provided for in this Declaration. In addition, any other party to whose benefit this Declaration inures shall have the right, in the event of violation or breach of this Declaration, to prosecute a proceeding at law or in equity against the Person or Persons who have violated or are attempting to violate this Declaration, to enjoin or prevent them from doing so, to cause said violation to be remedied and to recover damages for said violation.

20.3 **Waiver.** The failure of any Owner, Declarant or the Association to enforce any provision of this Declaration shall in no event be deemed a waiver of the right to do so thereafter, and neither any Owner, Declarant nor the Association shall have any liability for such failure of such Owner, Declarant or the Association to enforce any provision of this Declaration.

ARTICLE 21
LITIGATION EXPENSES

If the Operator, Declarant, any Owner or the Association brings an action against any other Owner or Occupant by reason of a breach or alleged violation of any covenant, term or obligation of this Declaration, or for the enforcement of any provision of this Declaration or otherwise arising out of this Declaration, the prevailing party in such action shall be entitled to its cost of suit and reasonable attorneys' fees, which shall be made part of any judgment rendered in such action.

ARTICLE 22
NO ASSIGNMENT OR TRANSFER

The rights, powers, duties and obligations conferred upon the Owners pursuant to this Declaration shall not at any time be transferred or assigned by any Owner, except (a) in the case of the rights, powers, duties and obligations of Declarant, by Declarant pursuant to the definition of "Declarant" set forth in Article 27; or (b) in the case of any Owner, (i) through a transfer of the Owner's interest in its Lot in the manner provided in Article 23, or (ii) to a qualified Occupant pursuant to Section 1.3.

ARTICLE 23
SALE BY OWNER

Upon the sale, transfer, conveyance or assignment by any Owner of its right, title and interest in its Lot, the following shall apply:

23.1 **Notice.** The transferring Owner shall give prompt written notice of the sale, transfer, conveyance or assignment to the Operator, the Association and Declarant, as long as Declarant owns a Lot. Such notice shall set forth the name of the transferee and the transferor, the description of the affected Lot, the nature of the interest transferred, the transferee's mailing address and the date of transfer. Prior to receipt of such notification, any and all communications required or permitted to be given under the Project Documents shall be deemed to be duly given to the transferee if duly and timely given to said transferee's transferor.

23.2 **Constructive Notice and Acceptance.** Each Owner and Occupant, and every other person who now or hereafter owns or acquires any right, title, estate or interest in or to any portion of the Project, by acceptance of a deed, lease or other interest therein, shall be conclusively deemed to have consented and agreed to hold such title, leasehold or interest subject to and to comply with every covenant, condition and restriction contained herein and to the rights of Declarant, the Operator and the Association hereunder, whether or not any reference to this Declaration is contained in the deed, lease or other instrument by which such person acquired said interest in the Project. Every provision of this Declaration, regardless of its characterization herein, shall be deemed a covenant, condition, restriction, reservation, easement or servitude, as the circumstances may require, to permit the enforcement thereof and to carry out the intent of this Declaration.

23.3 **Release of Owner.** A transferring Owner shall be released from all obligations of this Declaration as of the effective date of the transfer; provided that with respect to the period before the effective date of the transfer, such Owner is not in default in the performance of any duties or obligations arising under this Declaration or in the payment of any amounts due and payable under this Declaration.

23.4 **Liability of Transferee.** In no event shall any transferee of any Owner be liable for any default of the transferring Owner under this Declaration which occurred prior to the effective date of the transfer; provided, however, nothing contained in this Section shall affect the existence, priority, validity or enforceability of any lien placed upon the transferred Lot or portion thereof pursuant to Section 2.10.

ARTICLE 24
TERM OF DECLARATION

Subject to the provisions of Article 14 hereof, this Declaration shall run with the land and continue in full force and effect for a period of ninety nine (99) years and thereafter year to year, unless, within three (3) months prior to expiration of the term (as it may be so extended), a written instrument duly signed and acknowledged by the Declarant, if the Declarant still owns a Lot within the Project, and Owners (which may include Declarant) holding at least seventy-five percent (75%) of the Members voting power is recorded in the Office of the County Recorder of Santa Barbara County, California terminating this Declaration in whole or in part as to all or a portion of the Property.

ARTICLE 25
MISCELLANEOUS

25.1 **Assignment.** Notwithstanding any provision of this Declaration to the contrary, Declarant may, at any time, relieve itself of its rights and obligations under this Declaration (including all obligations and duties as the Operator) by recording a notice stating that Declarant has surrendered said rights and obligations and, upon recordation of such notice, even if it is not specified therein, said powers and obligations shall immediately vest in the Association. If at any time Declarant ceases to exist and has not made such an assignment, the rights and obligations of Declarant (including all obligations and duties as the Operator) shall automatically vest in the Association.

25.2 **Constructive Notice and Acceptance.** Each Owner and Occupant, and every other person who now or hereafter owns or acquires any right, title, estate or interest in or to any portion of the Property, by acceptance of a deed, lease or other interest therein, shall be conclusively deemed to have consented and agreed to hold such title, leasehold or interest subject to, and comply with, every covenant, condition and restriction contained herein and to the rights of Declarant hereunder, whether or not any reference to this Declaration is contained in the deed, lease or other instrument by which such person acquired such interest in the Property. Every provision of this Declaration, regardless of its characterization herein, shall be deemed a covenant, condition, restriction, reservation, easement or servitude, as the circumstances may require to permit the enforcement thereof and to carry out the intent of this Declaration.

25.3 **Estoppel Certificate.** Each Owner and Mortgagee shall, upon reasonable request to Declarant, the Association, or the entity then charged with enforcement of the terms of this Declaration, be entitled to receive a statement specifying the nature of any known default of such applicable Owner. For such statement, Declarant, the Association or such other certifying party, shall be entitled to charge a reasonable fee based upon administrative expenses.

25.4 **Captions.** Captions and Section headings, where used in this Declaration, are for convenience of reference only, are not intended to be a part of this Declaration and in no way define, limit, amplify, change, alter or describe the scope or intent of the particular paragraphs to which they refer.

25.5 **Gender.** For the purpose of this Declaration, the neuter gender includes the feminine or masculine and the singular number includes the plural.

25.6 **Declarant's Reserved Rights.** Wherever it appears in this Declaration that Declarant has the right to waive compliance with certain provisions, the right to approve or deny certain matters or the right to exercise its discretion in various areas, these rights of the Declarant are expressly reserved or retained by Declarant, and all of the provisions of this Declaration are subject to such retained and reserved rights.

25.7 **Exhibits.** All exhibits referred to herein are attached hereto and incorporated by reference.

25.8 **Governing Law.** This Declaration shall be governed, construed and enforced in accordance with the Laws of the State of California.

25.9 **Mortgage Protection.** No breach of this Declaration shall affect, impair, defeat or render invalid the lien of any Mortgage now or hereafter executed in good faith and for value upon any part of the Project, except for the foreclosure of an assessment lien that is superior to such Mortgage, if any, pursuant to Section 2.10 above. However, if any portion of the Project is sold under a foreclosure of any Mortgage or is conveyed to the party so secured in lieu of foreclosure, any purchaser at such sale, and his successors and assigns, shall hold any and all property so acquired subject to all of the restrictions and other provisions of this Declaration. Such a purchaser shall not be obligated to cure any preexisting breach of this Declaration which is non-curable by payment of money (subject to Section 2.10) or of a type which is not practical or feasible to cure. Any loan to facilitate the resale of any portion of the Property after a foreclosure sale or deed in lieu of foreclosure is a loan made in good faith and for value. If a Mortgagee delivers written notice of its Mortgage to the Operator together with a request for notices of default with respect to the Lot or Lots encumbered by the Mortgage, the Association shall deliver copies of all such notices of default to such Mortgagee (a **"Requesting Mortgagee"**) concurrently with delivery to the Owner or Owners. A Requesting Mortgagee shall also be entitled to timely written notice of any destruction, taking or threatened taking that affects a material portion of the Common Areas (including without limitation any Common Parking Area) benefiting a Lot securing the Mortgage, and any lapse, cancellation or material modification of any insurance policy maintained by the Operator. Mortgagees are hereby authorized to furnish information to the Operator concerning the status of any Mortgage. Nothing contained in this Declaration or the other Project Documents shall give the Operator, the Association, any Owner, or any other party priority over the rights of a Mortgagee with respect to distributions of insurance proceeds or condemnation awards for losses to or a taking of a Lot or Building, or any portion thereof, encumbered by a Mortgage held by such Mortgagee.

25.10 **Mutuality, Reciprocity; Runs With Land.** This Declaration is designed to create equitable servitudes and covenants appurtenant to, and for the direct, mutual and reciprocal benefit of each and every Lot, running with the Property, in accordance with the provisions of California Civil Code Section 1468. The covenants, conditions, restrictions, reservations, equitable servitudes, liens and charges set forth herein shall run with the Property and shall be binding upon all persons having any right, title or interest in the Property, or any part thereof, their heirs, successive owners and assigns; shall inure to the mutual benefit of, and be enforceable by, persons having right, title or interest in any Lot, their heirs, successive owners and assigns; and shall be binding upon Declarant, its successors and assigns and all successors in interest with fee interests in all or any portion of the Property. Declarant hereby declares its understanding and intent that the burden of the covenants set forth herein touch and concern the land.

ARTICLE 26
RIGHTS AND REQUIREMENTS OF THE CITY OF GOLETA

26.1 **General.** Notwithstanding any other provision to the contrary as may be contained in this Declaration, and in addition to all other rights granted to the City pursuant to the provisions of this Declaration, the City shall have the following additional rights, and Declarant, the Operator and the Owners, as applicable, shall comply with the following provisions, City requirements and conditions:

26.2 **Definitions.** For purposes of this Article, the term "Improvements" shall have that meaning set forth in this Declaration, if any, but shall also include all improvements in the Project, including, without limitation, the following: all structures and buildings (and all components thereof); private utilities; landscaping improvements and plantings; fences and walls, private streets and driveways, sidewalks, parking areas, garages, carports, lighting, signs, irrigation and drainage facilities.

26.3 **Maintenance and Waste Management.** Declarant, the Operator and each Owner shall comply with the following special conditions:

(a) Owner Maintenance. Each Owner, including Declarant, shall, at all times, perform such maintenance as is required to be performed by an Owner under this Declaration in accordance with the terms of this Declaration and applicable City codes and regulations.

(b) Landscape Maintenance. All landscaping in the Project, including, without limitation, trees, shrubs and other vegetation, drainage and irrigation systems, shall be maintained by the Owners in conformity with the landscaping maintenance standards of the City. Dead or diseased plants shall be promptly replaced with landscaping similar in type, size and quality.

(c) Parking and Driveways. Driveways and traffic aisles within the Project shall be kept clear and unobstructed at all times. No vehicles or other obstruction shall project into such driveways or traffic aisles. All private streets or driveways, sidewalks and parking areas shall be regularly swept and cleaned. All asphalt and concrete paved areas shall be repaired, replaced, and re-striped, as necessary, to maintain said pavement at all times in a level and smooth condition. Any traffic or parking signage will be properly maintained.

(d) Waste Management. Each Owner, including Declarant, shall comply with a Solid Waste Management Plan which shall be developed by Declarant and implemented by the Operator which shall include without limitation:

(i) Provision for designated space and/or bins for storage of recyclable materials including office paper, cardboard, and beverage containers within each Occupant's suite in the Project;

(ii) Development of a plan for accessible collection of materials on a regular basis:

(iii) Regular composting of lawn clippings and other landscape materials;

(iv) Provision of a tenant/employee education pamphlet to be used in conjunction with available Santa Barbara County and federal source reduction educational materials. The pamphlet shall be provided to all tenants by the leasing/property management agency;

(v) Purchase and use of materials made of recycled materials;

(vi) Encouragement of two-sided copying and use of reusable dishware in employee kitchen areas;

(vii) Inclusion of lease language requiring tenant participation in recycling/waste reduction programs, including the specification that janitorial contracts include compliance with recycling requirements;

(viii) A monitoring program (annual) to ensure at least fifty percent (50%) participation in overall waste disposal, using source reduction, recycling, and/or composting programs.

26.4 **City as Third Party Beneficiary.** Each Owner acknowledges by acceptance of the deed or other conveyance therefor, whether or not it shall be expressed in any such deed or other instrument, that each of the covenants, conditions and restrictions set forth in this Article benefit the City, and that the City has a substantial interest to be protected with regard to compliance with these covenants, conditions and restrictions and any amendments thereto.

26.5 **Easement for Law Enforcement and Emergency Vehicles and Personnel.** Declarant hereby reserves a non-exclusive easement for access, ingress and egress upon and across the Project as may be necessary for law enforcement and for the provision of emergency services in the Project by City and state and federal law enforcement officers and vehicles, City Fire Department and other emergency services vehicles and personnel.

26.6 **Agreement Between Declarant and City.** The Declarant, in exchange for receiving the City's approval of this Declaration, hereby agrees to hold, sell and convey the Project subject to the covenants, conditions, restrictions and reservations contained in this Article.

26.7 **Compliance with Law.** Declarant, the Association and each Owner shall comply with state and federal law and with all ordinances, regulations and standards of the City, and any assessment district of the City, as may be applicable to the Project.

26.8 **No City Liability.** The failure or refusal of the City to exercise any of the rights or powers conferred by this Article will not result in any liability to the City and shall not give rise to a cause of action against the City, its officers and employees, on the part of any person. No officer or employee of the City shall be personally liable to the Declarant, the Association or any Owner, for any default or breach by the City, its officers and employees, under this Declaration.

26.9 **Amendments/Termination.** Any termination of this Declaration, and any amendment to any provision of this Article or to any other provisions of this Declaration which affects the rights of the City under this Article shall require the prior written consent of the Goleta City Manager (or his authorized representative) prior to recordation. The City's prior written approval shall be contained within or recorded concurrently with any such amendment or termination. Any such amendment or termination recorded without the City's written approval shall be null and void.

26.10 **Attorneys' Fees.** In any action brought by the City to enforce this Declaration, the prevailing party will be entitled to receive its attorney's fees and costs, in addition to such other relief as may be granted. In addition, the City shall be entitled to receive its attorney's fees and costs expended in connection with (a) enforcement of this Article, and (b) any settlement procedure as may be ordered by the court. To the extent the Operator and/or any individual Owner is a non-prevailing party in any enforcement action, the Operator and the individual Owner against whom such enforcement action has been taken shall be jointly and severally liable for any such attorneys' fees and costs.

26.11 **Notices.** Notices to the City that may be required or necessary under this Declaration, if any, shall be provided to the following addresses:

To City:
City of Goleta
130 Cremona Drive, Suite B
Goleta, CA 93117
Attn: Planning and Environmental Services Department

With Copy to:
City of Goleta
130 Cremona Drive, Suite B
Goleta, CA 93117
Attn: City Attorney

ARTICLE 27
DEFINITIONS

In addition to any other terms defined in this Declaration, the following definitions shall apply unless otherwise indicated:

"Affiliate" – Any Person which owns, is owned by, is controlled by, controls, or is under common control with, another Person.

"Allocated Parking Spaces" - With respect to each Building, the number of parking spaces (including visitor parking spaces) allocated to each such Building by this Declaration and the applicable governmental authority as necessary to provide required parking (including parking for Occupants and Permittees [including visitors]) for the uses to be conducted in or about the Building in question based upon the Maximum Floor Area (as defined herein) for such Building, together with such additional parking spaces, if any, as may from time to time be allocated to such Building by the Operator as provided herein. Allocated Parking Spaces for a Building may be situated entirely upon the Lot upon which such Building is situated and may comprise all of the Parking Spaces situated upon such Lot in which case such Allocated Parking Spaces shall constitute Exclusive Use Area for the Owner of such Lot and shall not constitute Common Parking Areas. Allocated Parking Spaces for a Building may alternatively be located upon the Lot upon which

such Building is situated and/or upon other adjacent Lots and may therefore constitute Common Parking. Allocated Parking Spaces may granted by one Building Lot Owner to another Building Lot Owner by easement. Allocated Parking Spaces granted to a Building are granted in consideration for payment by the Owner of such Building of (i) all costs and expenses associated with the use, maintenance and repair of such Allocated Parking Spaces if they shall constitute Exclusive Use Area as to such Owner, or (ii) such Owner's share of Common Expenses attributable to such Common Parking Areas if they shall be situated within Common Parking Areas as provided herein and shall be taken into account in establishing the Deemed Land Area of each Building Lot as provided herein and as shown on Exhibit "D" attached hereto. The Allocated Parking Spaces for each Building are set forth in Architectural Sheet #3 to the Development Agreement for the Project, the relevant parking provisions of which are attached hereto as Exhibit "D". subject to change from time to time based upon changes to development and uses within the Project as provided herein and in the Development Agreement or other City approved modifications to the Project.

All parking spaces located upon a Lot shall be part of the Common Parking Areas unless designated as Exclusive Use Areas pursuant to this Declaration. All allocations of parking within Common Parking Areas shall be on a non-exclusive basis, except for permitted reserved parking spaces as may be provided herein, among those entitled to use such Common Parking Areas and shall be made by Declarant or the Operator in a reasonable and non-discriminatory manner. The allocations of Allocated Parking Spaces may be confirmed as a part of any sale instrument covering a Lot and/or Improvements thereon, but shall remain subject to adjustment at any time by Declarant or the Operator based upon the actual Floor Area of the Building(s) actually constructed upon the Lots, modifications or additions thereto, requirements of the City and usage experience as to the parking required with respect to the Building(s) in question (consideration being given to peak period and off-hour usage for the businesses conducted within such Buildings, the availability of overflow parking within the Common Areas, etc.).

Accordingly, it is to be noted that the actual total number of parking spaces within the Common Parking Areas may be greater or less than the total number of Allocated Parking Spaces serving the Buildings served by such Common Parking Areas because (i) Owners may elect to build excess parking spaces upon their respective Lots to service their Buildings; or (ii) different hours of operation or peak parking requirements for different Occupants may permit a reduction in the total number of parking spaces required to be built to accommodate all uses within the Project. Further, the Allocated Parking Spaces shall remain at all times subject to the exercise by Declarant of its rights pursuant to Section 7.2 hereof and subject to requirements of the City. Allocated Parking Spaces shall be made available to the Owner(s), Occupants and Permittees (including visitors) of a Lot commencing upon issuance of a certificate of occupancy or equivalent for the Building constructed upon such Lot. Notwithstanding any of the foregoing, the number of Allocated Parking Spaces for any Lot shall not be reduced by Declarant below that necessary to provide such Lot with the minimum number of parking spaces required by the City to be provided for any Building(s) located on such Lot at the time of the initial construction thereof taking into account any and all parking for such Building which is located upon such Lot, without Declarant first obtaining the consent of the City, the Owner of, and any Mortgagee that has a Mortgage on, such Building(s).

"Architect" – A Person holding a certificate to practice architecture in the State of California under authority of Division 3, Chapter 3 of the BUSINESS & PROFESSIONS CODE of the State of California or any successor legislation thereto.

"Articles" – The Articles of Incorporation of the Association which are or shall be filed in the office of the California Secretary of State, as amended and supplemented from time to time.

"Assessment, Capital Improvement" – "Capital Improvement Assessment" shall mean a charge against each Owner and such Owner's Lot, representing a portion of the costs to the Operator for installation or construction of any Improvements on any portion of the Common Area which the Operator may from time to time authorize, pursuant to the provisions of this Declaration. Such charge shall be levied among all Owners and their Lots in the same proportion as Regular Assessments, unless otherwise determined by the Operator as provided in Section 2.4.

"Assessment, Reconstruction" – "Reconstruction Assessment" shall mean a charge against each Owner and such Owner's Lot representing a portion of the cost to the Operator for reconstruction of any Common Area Improvements pursuant to the provisions of this Declaration. Such charge shall be levied among all Owners and their Lots in the same proportion as Regular Assessments, unless otherwise determined by the Operator as provided in Section 2.4.

"Assessment, Reimbursement" – "Reimbursement Assessments" shall mean a charge against a particular Owner and such Owner's Lot directly attributable to, or reimbursable by, that Owner equal to the cost incurred by the Operator for corrective action performed pursuant to the provisions of this Declaration, or a reasonable fine or penalty assessed by the Operator, plus interest and other charges on such Special Assessments as provided for herein. Reimbursement Assessments shall also include charges levied by the Operator against an Owner and such Owner's Lot for excessive use of any utility which is commonly metered within the Property.

"Assessment, Regular" – "Regular Assessment" shall mean the monthly or supplemental charge against each Owner and such Owner's Lot representing a portion of the Common Expenses, including Common Water Expenses, which are to be paid by each Owner to the Operator in the manner and proportions provided herein.

"Assessments, Special" – "Special Assessments" shall mean Capital Improvements Assessments and Reconstruction Assessments and any other assessment imposed by the Operator against any Owner(s) which are not Regular Assessments or Reimbursement Assessments, including, without limitation, Assessments by the Association to each Owner for Private Water Use by each such Owner.

"Association" – Cabrillo Business Park Owners Association, a California Nonprofit Mutual Benefit Corporation.

"Benefited Lot" – Any Lot which, pursuant to the terms of this Declaration, is the beneficiary of any right or benefit granted herein or created pursuant to the terms hereof.

"Board" – The Board of Directors of the Association, as the same may be constituted from time to time.

"Building" – Any structure now or hereafter constructed on any Lot which is intended for human occupancy including, without limitation, the eight (8) existing Buildings and contemplated Buildings 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11 and 12.

"Building Appurtenances" - Truck docks, tunnels, ramps and wells, trash storage areas and equipment, outdoor seating and patio areas, fountains and other architectural features servicing exclusively one (1) or two (2) Buildings, landscape and hardscape areas immediately appurtenant to a Building and supports and appurtenances that extend from a Building as permitted by this Declaration, such as Building canopies, support columns, pilasters, overhangs and footings, provided that such Improvements are located immediately adjacent to a Building or other Building Appurtenance as permitted by this Declaration, or, with the Operator's prior written consent, within an Exclusive Use Area of a Common Area Lot as designated or approved by the Operator.

"Building Area" - Prior to the commencement of construction or remodeling of a Building, that area of the Lot in question which is designated as a Building Area on the Site Plan or approved construction drawings for the Building; and from and after the commencement of construction or remodeling of a Building structure on a Lot, the Building Area shall conform to the footprint of the Building Improvements constructed thereon. Notwithstanding the foregoing, in no event shall any Building be constructed in an area not shown as Building Area on the Conceptual Site Plans attached hereto; provided, however, Building Appurtenances may, with the prior written consent of the Operator be constructed outside of a Building Area as designated or approved by the Operator.

"Building Lot" – Any Lot upon which Buildings and Building Appurtenances are or may be constructed under applicable Laws, specifically excluding all Common Area Lots.

"Bylaws" – The Bylaws of the Association, as amended and supplemented from time to time.

"City" – The City of Goleta, California, a municipal corporation.

"Committee" – The Architectural and Development Review Committee created pursuant to Article 3.

"Common Areas" — Those portions of the Project intended for the common use of Owners, Occupants and Permittees, and comprised of vehicular and pedestrian access areas and driveways, sidewalks, curbs, gutters and loading areas, Common Parking Areas and the parking spaces situated therein, parking bumpers, signage and other improvements located within such Common Parking Areas, Common Lighting Facilities, Common Landscaping, Common Drainage and Irrigation Facilities, Common Signage, Common Utility Lines, Common Water Lines and any other portion of the Property over which all Owners and/or the Operator have rights or obligations of use, beneficial enjoyment or maintenance pursuant to the terms of this Declaration or the conditions of approval of the Final Map (as defined below) or pursuant to any other governmental approval affecting the Property; excepting therefrom, however, all Buildings, Building Appurtenances, Private Water Lines and all other areas of the Project which are, or from time to time may be, designated by the Operator as **"Exclusive Use Areas"** for the exclusive use of one or more Owners, Occupants and/or Permittees, including, without limitation, the Exclusive Parking Areas situated upon Lots 3,8, 11 and 12 and all Exclusive Use Improvements which may be located within an Exclusive Use Area as designated or approved by the Operator. The Common Areas generally depicted on either of the Site Plans attached hereto as **Exhibits "B-1"** and **"B-2"** may be modified from time to time to change the location or configuration thereto or to reflect the requirements of the City or other governmental authorities by recordation of a Supplemental Declaration executed by Declarant or the Operator, subject to Article 14. Notwithstanding anything contained in this Declaration to the contrary, all Parking Areas of Lots 3, 8, 11 and 12 other than driveways, drive aisles, sidewalks, Common Utilities, Common Drainage and Facilities and Common Signage located on such Lots shall constitute Exclusive Use Areas for the exclusive use of the Owner(s) and Occupants and Permittees of Lots 3, 8, 11 and 12, respectively, and shall not constitute part of the Common Areas of the Project.

"Common Area Improvements" – All Improvements (other than Improvements within Exclusive Use Areas) which are from time to time located upon or within the Common Areas including, without limitation, Common Lighting Facilities, Common Landscaping, Common Parking Areas, Common Signage, Common Utility Lines, Common Water Lines and Common Drainage and Irrigation Facilities.

"Common Area Lot" - Each Lot which Declarant may from time to time designate as a Lot upon which primarily Common Area Improvements including Common Parking Areas and Driveways are to be constructed, including without limitation, Lots 15, 16, 17 and 18. Declarant hereby designates Lots 15, 16, 17 and 18 as the initial "Common Area Lots" for the Project.

"Common Drainage and Irrigation Facilities" – The on-site private drainage, landscape irrigation and sewer facilities and structures or portions thereof which serve the Common Areas or all of the Buildings in the Project, as the same may from time to time exist within the Project, including, without limitation, all common bio-swales located within the Project.

"Common Expenses" – All costs, fees and expenses incurred by the Association and/or Operator in connection with the ownership, operation, management, maintenance, repair and restoration of the Common Areas of the Project and all property of the Association, if any, including, without limitation, the actual and estimated costs and expenses of maintaining and operating the Association; Real Property Taxes assessed on Common Area Lots, if any (it being intended that the property value, if any, of any Common Area Lots be allocated by the taxing authority ratably as part of the property value of all Building Lots within the Project); costs of property management fees and costs associated with administration and operation of the Project including compensation paid to attorneys, managers, accountants and contractors; costs and expenses of maintaining and operating all Common Areas and all Common Area Improvements (excluding costs and expenses associated with any Exclusive Use Areas); the cost of utility services for the Common Areas (excluding costs of utilities for any Exclusive Use Areas) including Common Water Costs, and for the maintenance, repair and replacement of Common Utility Lines, Common Water Lines, Common Landscaping, Common Lighting Facilities, Common Parking Areas, Common Signage and Common Drainage and Irrigation Facilities; the cost of insurance maintained by the Operator as described herein or in the Bylaws including, without limitation, public liability insurance, property insurance, worker's compensation insurance, fidelity coverage and other forms of insurance customarily obtained by persons or firms performing functions similar to those performed by the Operator hereunder for projects similar to the Project; and the costs and expenses of exercising the powers and performing any and all of the duties of the Operator under this Declaration, the Project Documents, the Articles, the Bylaws and any rules or regulations adopted by the Association including, without limitation, the cost of all services, utilities, materials and equipment (and personal property taxes thereon, if any) required in connection therewith, but excluding the costs of all initial, original construction of Common Area Improvements; and maintaining any reasonable reserves for such purposes as determined by the Operator. To the extent any Common Expenses are common to more than one, but not all Owners or Buildings within the Project, the Operator shall allocate such Common Expenses on an equitable basis as between only such Owners that share the benefits associated with such Common Expenses.

"Common Landscaping" – Landscaping and related irrigation system improvements, facilities and equipment located upon any Common Area Lot or located upon any Building Lot to the extent comprising part of the Common Area to be maintained by the Operator, as the same may from time to time exist within the Project, including, without limitation, all shared frontage landscaping which fronts any public or interior private streets abutting the Project, all landscaped medians within the street right of way on Hollister and Los Carneros Avenues, and all public infrastructure landscaping within the Project including all park and wetlands areas within the Project once such wetlands areas are accepted by the applicable public agency.

"Common Lighting Facilities" – The light standards and fixtures, light bulbs, tubes, electrical transformers, power panels, utility lines, and above and below ground electrical conduit and wiring which serve the Common Areas including the Common Parking Areas, Common Landscaping and Common Signage, as the same may from time to time exist within the Project.

"Common Parking Areas" – Those portions of the Common Areas, consisting of Parking Areas, as the same may from time to time exist within the Project which may he utilized by the Owners and Occupants of more than one Lot and their Permittees in common as provided in Section 7.2.

"Common Parking Expenses" – Common Expenses, including Real Property Taxes, and costs of utilities and insurance attributable to Common Parking Areas.

"Common Signage" – All signage located within the Common Areas of the Project (specifically excluding tenant or other Occupant identification signage) which identifies the Project, the Project management company, parking operator, listing agent(s) or which provide other Project-oriented information including, without limitation, Project directional signage.

"Common Utility Lines" – All above or below ground utility lines (including water, electrical, gas, sewer and storm drains) which either (i) service Common Area Improvements, whether exclusively or in common with other Improvements (including, without limitation, Common Area Lighting Facilities and Common Area Landscaping Improvements and all utilities which service water features within the Project, if any), or (ii) serve more than one Building or Building Site. Common Water Lines shall be included within Common Utility Lines.

"Common Water Costs" – the costs, as reasonably determined by Operator of all water service to provided within the Project pursuant to Common Water Lines including without limitation costs to supply water for Common Areas and Common Landscaping.

"Common Water Lines" – All above or below ground water lines, meters and sub-meters located or installed within the Project from the "customer side" of the two (2) main water meters installed by the Goleta Water District which serve the Project located at Hollister Avenue and Los Carneros Road, to the extent such water lines, meters and sub-meters either (i) service Common Area Improvements, whether exclusively or in common with other Improvements (including, without limitation, Common Area Landscaping Improvements and water features within the Project, if any), or (ii) serve more than one Building or Building Site to the point at which such water line exits a sub-meter as a water line serving only a single Building or Building Site thereby becoming a Private Water Line.

"Declarant" – Santa Barbara Realty Holding Company, LLC, a Delaware limited liability company **("SBRHC")**, and any successor-in-interest (defined below). As used in this definition, a **"successor-in-interest"** of SBRHC shall mean a Person which, through a purchase or acquisition of stock or partnership interest(s), amalgamation, consolidation, reorganization, dissolution, merger or similar transaction (as opposed to a purchase, transfer or conveyance of one or more Lots), becomes vested with the rights and assumes the obligations of SBRHC, as "Declarant", pursuant to this Declaration. **"Declarant"** shall also mean the transferee from SBRHC or its successor-in-interest of any one or more Lots comprising a portion of the Project, provided SBRHC or its successor-in-interest expressly assigns to such transferee the rights of "Declarant" and such transferee assumes the obligations of "Declarant" under this Declaration; any such assignment and assumption of the rights and obligations of "Declarant" shall be in writing and signed by both SBRHC or its successor-in-interest and by the transferee in recordable form and shall be recorded by the transferee in the Office of the County Recorder of Santa Barbara County, California.

"Declaration" – This Declaration of Covenants, Conditions and Restrictions and Grant and Reservation of Easements for Cabrillo Business Park, as it may be amended or supplemented from time to time.

"Deemed Area of Land" is defined in Section 2.4(b).

"Design Guidelines" – Guidelines, rules and regulations which may be prepared and issued from time to time (and which may be amended from time to time) by the Committee, and approved and adopted by the Operator for the purpose of assisting Owners in preparing plans and specifications for Improvements and in preparing other plans, specifications and other materials (including designs for signs and the like) which are subject to review by the Committee pursuant to this Declaration.

"Development Agreement" – That certain Development Agreement dated May 7, 2007 and recorded June 25, 2007 as Instrument No. 2007-0046722 by and between Santa Barbara Realty Holding Company, LLC and the City of Goleta.

"Environmental Laws" – Any past, present or future federal, state, local or foreign statutory or common law, or any regulation, ordinance, code, plan, order, permit, grant, franchise, concession, restriction or agreement issued, entered, promulgated or approved thereunder, relating to (a) the environment, human health or safety, including, without limitation, emissions, discharges, releases or threatened releases of Hazardous Materials into the environment (including, without limitation, air, surface water, groundwater or land), or (b) the manufacture, generation, refining, processing, distribution, use, sale, treatment, receipt, storage, disposal, transport, arranging for transport, or handling of Hazardous Materials.

"Exclusive Parking Areas" – all Parking Areas situated within any Lot in the Project which are expressly reserved and dedicated solely for use by the Owner, Occupants and Permittees of the Building situated upon such Lot and which are designated as Exclusive Use Areas of the Owner of such Lot and are therefore maintained and repaired by such Owner and not the Association as provided in this Declaration, including without limitation, all Parking Areas situated on Lots 3, 8, 11 and 12. Exclusive Parking Areas shall be distinguished from Reserved Parking Areas which shall be Common Parking Areas expressly reserved for the use of a particular Owner, Occupant or Permittee or class of Permittee, but maintained and repaired by the Association as part of the Common Areas of the Project.

"Exclusive Use Areas" – Those portions of the Project designated as Exclusive Use Areas from time to time by Declarant or the Operator in writing for the exclusive use of one or more, but not all, Owners and their respective Occupants and Permittees including, without limitation, each Building within the Project; and all Building Appurtenances and similar areas immediately appurtenant to an Owner's Building(s) and the Private Water Lines serving such Building which are designated or approved by the Operator as for the exclusive use of such Owner(s) and such Owner(s)' Occupants and Permittees and are to be used, maintained and/or repaired by the Owner(s) and Occupant(s) of such Building(s) as provided herein, including, without limitation, the Exclusive Parking Areas located on Lots 3, 8, 11 and 12 and those other areas designated as Exclusive Use Areas on the Site Plans attached hereto as **Exhibit "B-2"**. Each and every Exclusive Use Area and all Exclusive Use Area Improvements associated therewith shall be maintained, repaired, insured and replaced by the Owner(s) of the Building(s) benefited by such Exclusive Use Area unless the Operator shall agree in writing to assume such obligations at the sole cost and expense of such Owner(s). If any Exclusive Use Area is shared by the Owners of more than one Building in the Project, then all Exclusive Use Area Expenses attributable to the operation, maintenance, insurance, repair and replacement of such Exclusive Use Area and all Exclusive Use Area Improvements associated therewith shall be shared by the Owners of the Buildings sharing in the use of such Exclusive Use Area on an equitable basis based upon the respective usage of or benefits derived from such Exclusive Use Area and Exclusive Use Area Improvements by such Owners as reasonably determined by such Owners.

"Exclusive Use Area Expenses" – Costs and expenses incurred by the Operator in performing its duties or services for or at the request of any Owner with respect to any Exclusive Use Area or Exclusive Use Area Improvements which would constitute Common Expenses but for the fact that they are incurred with respect to an Exclusive Use Area or Exclusive Use Area Improvements rather than Common Area or Common Area Improvements.

"Exclusive Use Area Improvements" – All Improvements constructed upon or within or comprising any portion of an Exclusive Use Area, including, without limitation, Private Water Lines and back-up generator equipment serving any Building(s) and located within any portion of the Common Area designated as Exclusive Use Area by the Operator, including, without limitation, those areas designated as Exclusive Use Areas on the Site Plans attached hereto as **Exhibits "B-2"**.

"Final Map" – The Final Maps for Cabrillo Business Park Vesting Tentative Tract Map No. 37-SB-TM [Alternative 7] (the "Tentative Map"), which is filed in the Office of the Recorder of Santa Barbara County, California as to any Lots within the Project based on the Tentative Map and any modifications thereto including all conditions of approval as to any such Final Map, as the same may be amended from time to time. The first Final Map for the Project is Map 37-SB-0 and establishes Lots 13, 14, 20, 21 and 22 as Lots within the Project. Final Map 37-SB-A establishes Lots 1, 2, 3 and 4 as Lots within the Project.

"Floor Area" – The total floor area of any Building within the Project as reasonably determined by the Operator based on industry standards and practices for the measurement of the type of Building in question based upon construction method and designated use. Upon any material alteration or modification of any Building which may materially affect the determination of Floor Area, the Floor Area for such Building and for the Project shall be recomputed as set forth in this Section. The party or parties who cause such alteration or modification of any such Building shall pay for the cost of recomputation. From time to time, as deemed appropriate by the Operator, the Operator shall have the right to execute and record a supplement to this Declaration, to set forth the Floor Area of all Buildings then existing in the Project. Such supplement need only be executed by the Operator and each supplement shall replace any previously recorded supplement.

"GWD" – The Goleta Water District.

"Hazardous Material" - Any hazardous or toxic substance, material or waste which is or becomes regulated by, or is subject to, or governed under, any local governmental authority, any agency of the State of California or any agency of the United States Government. The term "Hazardous Material" includes, without limitation, any material or substance which is (i) defined as a "hazardous waste," "extremely hazardous waste" or "restricted hazardous waste" under Sections 25115, 25117 or 25122.7, or listed pursuant to Section 25140, of the California Health and Safety Code, Division 20, Chapter 6.5 (Hazardous Waste Control Law), (ii) defined as a "hazardous substance" under Section 25316 of the California Health and Safety Code, Division 20, Chapter 6.8 (Carpenter-Presley-Tanner Hazardous Substance Account Act), (iii) defined as a "hazardous material," "hazardous substance," or "hazardous waste" under Section 25501 of the California Health and Safety Code, Division 20, Chapter 6.95 (Hazardous Materials Release Response Plans and inventory), (iv) defined as a "hazardous substance" under Section 25281 of the California Health and Safety Code, Division 20, Chapter 6.7 (Underground Storage of Hazardous Substances), (v) petroleum and any petroleum by-products, (vi) asbestos, (vii) urea formaldehyde foam insulation, (viii) listed under Article 9 or defined as hazardous or extremely hazardous pursuant to Article 11 of Title 22 of the California Administrative Code, Division 4, Chapter 20, (ix) designated as a "hazardous substance" pursuant to Section 311 of the Federal water Pollution Control Act (33 U.S.C. § 1317), (x) defined as a "hazardous waste" pursuant to Section 1004 of the Federal Resource Conservation and Recovery Act, 42 U.S.C. § 6901 et seq. (42 U.S.C. §6903), or (xi) defined as a "hazardous substance" pursuant to Section 101 of the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. § 9601 et seq. (42 U.S.C. § 9601).

"Improvements" – All structures and improvements of every type and kind, whether above or below the land surface, including, without limitation, all Buildings, Building Appurtenances, accessory structures, outbuildings, underground installations, Private Water Lines, slope and grade alterations, roads, curbs, gutters, storm drains, detention basins, drainage facilities including Common Drainage and Irrigation Facilities, utilities including Common Lighting Facilities, Common Utility Lines and Common Water Lines, driveways, Parking Area improvements, walls, fences, screening walls and barriers, retaining walls, stairs, decks, windbreaks, plantings, parks and wetlands areas, planted trees, shrubs and other landscaping including Common Landscaping, sidewalks, poles, signs including Common Signage, loading areas and docks.

"Laws" – All laws, statutes, ordinances, rules, regulations, requirements, permits, or approvals promulgated by any federal, state or local governmental entity with jurisdiction over the Project or any business, use or operation thereon, as the same may, from time to time, be amended, superseded, supplemented, modified or revised, including, without limitation, City of Goleta Ordinance 07-04 dated May 7, 2007, the Development Agreement, all City of Goleta conditions of approval for the Project (including, without limitation, the City TDM Plan requirements) and all Environmental Laws.

"Lot" – Each of Lots 1 through 22 and any further subdivision of such Lots or the Property into additional legal parcels or lots and any separate legal lot or parcel which is a portion of the Project, now existing or hereafter created after this Declaration is recorded, whether by a legal split, subdivision or other parcelization of a Lot, lot line adjustment, or by combination or merger of one or more Lots. Lots are referred to individually as a **"Lot"** and any two or more Lots may be referred to herein collectively as **"Lots"**. Each of the Lots and the approximate acreage and Floor Area of Improvements existing or to be constructed thereon, if any, are described on Exhibit "C" attached hereto.

"Manager" – The Person appointed by the Operator hereunder as its agent and to whom is delegated certain duties, powers or functions of, the Operator, as further provided in this Declaration.

"Maximum Floor Area" – The maximum Floor Area permitted to be constructed on each Building Lot pursuant to all applicable Laws as reflected in this Declaration or in the grant deed conveying title to such Lot from Declarant to its subsequent Owner or in such other document of record with respect to such Lot as may be executed by Declarant prior to conveyance of such Lot to a subsequent Owner. From and after such time as there shall be Building Improvements constructed upon all Lots within the Project (other than Common Area Lots), the Maximum Floor Area for each Lot within the Project shall be the actual Floor Area of the Buildings constructed upon each such Lot as the same may be expanded or reduced from time to time as permitted under all applicable Laws, taking into account the total Floor Area of all Buildings within the Project, not to exceed in any event, the fixed aggregate maximum Floor Area for each Lot set forth on Exhibit "C" attached hereto.

"Member, "Membership" – "Member" shall mean an Owner entitled to membership in the Association as provided in this Declaration, including Declarant. "Membership" shall mean the property, voting and other rights and privileges of Members as provided herein, together with the correlative duties and obligations contained in this Declaration and the Articles and Bylaws of the Association.

"Mortgage, Mortgagee, Mortgagor" – "Mortgage" shall mean any recorded mortgage or Deed of Trust or other conveyance of a Lot or other portion of the Property to secure the performance of an obligation which will be reconveyed upon the completion of such performance. The term "Deed of Trust" or "Trust Deed" when used herein shall be synonymous with the term "Mortgage." The term "Mortgagee" shall mean a person or entity to whom a Mortgage is made and shall include the beneficiary of a Deed of Trust. "Mortgagor" shall mean a person or entity who mortgages his or her Lot to another (i.e., the maker of a Mortgage), and shall include the Trustor of a Deed of Trust. The term "Trustor" shall be synonymous with the term "Mortgagor," and the term "Beneficiary" shall be synonymous with the term "Mortgagee."

"Occupant" – Any Person from time to time entitled by right of ownership or under any lease, sublease or license to use and occupy any portion of a Building on any Lot within the Project.

"Operator" – The Person designated from time to time pursuant to the provisions of this Declaration to operate, insure, maintain, repair and replace the Common Area, such Person to be, in the following order of precedence: (a) Declarant; (b) prior to the formation of the Association, any Person, whether owned in whole or in part and whether controlled directly or indirectly by the Declarant, to whom the Declarant may assign in writing its rights, duties and obligations under this Declaration by an express assignment which is recorded in the Official Records of Santa Barbara County, California, pursuant to Section 4.2, provided such assignee is an Owner of a Lot within the Project and accepts such assignment and assumes such duties and obligations of Declarant; and (c) the Association formed pursuant to Article 1 acting through its Board and the Committee, in the event (i) Declarant assigns to the Association in writing its rights, duties and obligations under this Declaration as provided in Article 1, (ii) Declarant and Declarant's successor, if any, ceases to own any interest in the Property without the Association having been previously formed, or (iii) any association which has become Declarant's successor ceases to exist (whether or not incorporated).

"Owner" – (i) Any Person (including Declarant) who from time to time holds fee title to any Lot within the Project, and (ii) an Occupant of an Owner's entire Lot (or of all of the usable area within the Building(s) on the Lot): (a) pursuant to a lease or sublease which, as of the date of the Owner's designation of the Occupant as Owner, has a remaining term of twenty (20) years or more, not including periods for which the term thereof may be extended by unexercised options to extend; and (b) designated as such by the Owner of the Lot pursuant to Section 1.3. If an Owner shall designate an Occupant as Owner for purposes of this Declaration, then the actual fee Owner shall not be deemed to be an Owner of such Lot during the period of such lease or sublease or such period of time as which the Lot Owner shall designate such Occupant as Owner, whichever is shorter. If the ownership of Improvements on a Lot shall be severed from the ownership of the land comprising such Lot, the Owner of the Improvements shall be deemed an Owner hereunder and shall be entitled to act on behalf of the Owner of the land for all purposes hereunder so long as such ownership rights shall be segregated.

"Parking Areas" – all paved areas of the Project which are striped for the parking of motor vehicles, consisting of Common Parking Areas and Exclusive Parking Areas.

"Permittees" – Occupants and all customers, patrons, employees, concessionaires and other invitees of Occupants.

"Person" – An individual, partnership, association, corporation, limited liability company, trust, governmental agency, administrative tribunal or any other form of business or legal entity.

"Phase" – An area of land within the Property consisting of one or more Lots together with landscaping, infrastructure and other Common Area Improvements associated with or necessary for the use and enjoyment of the Improvements to be constructed thereon, all of which are to be constructed concurrently with the construction of any initial Improvements upon such Lot(s).

"Phase 0" – Lots 13, 14, 20, 21 and 22 and all Improvements situated within or upon such Lots within the Project, all as shown on the Current Site Plan for the Project as of 1/1/09 attached hereto as **Exhibit "B-1".**

"Private Water Costs" – The costs, as reasonably determined by the Operator by separate metering of water usage to each Building and Building Site, of water service provided by the Operator to each Building and Building Site through Private Water Lines serving such Building and Building Site. Private Water Costs shall constitute Exclusive Use Area Expenses.

"Private Water Line" – Any water line within the Project which serves only a single Building or Building Site from the point of connection of such water line to a sub-meter installed and administered by the Operator to the point at which such water line connects to a single Building or Building Site.

"Project" – All of the Property described in Recital A and **Exhibit "A"**, including all Improvements now or hereafter located thereon, which shall be commonly known as Cabrillo Business Park.

"Project Documents" – This Declaration, the exhibits attached hereto, the Articles and Bylaws, and any Design Guidelines and rules and regulations as may be adopted from time to time by Declarant, the Committee or the Operator, all as amended or supplemented from time to time.

"Property" – The real property legally described on**Exhibit "A"**, including all Improvements now or hereafter located thereon, which is hereby subject to this Declaration. The Property, together with all such Improvements is also referred to herein as the Project.

"Real Property Taxes" shall mean all any form of real property tax or assessment, license fee, license tax, business license fee, commercial rental tax, levy, charge, improvement bond, tax, water and sewer rents and charges, utilities and communications taxes and charges or similar or dissimilar imposition imposed by any authority having the direct power to tax, including any city, county, state or federal government, or any school, agricultural, lighting, drainage or other improvement or special assessment district thereof, or any other governmental charge, general and special, ordinary and extraordinary, foreseen and unforeseen, which may be assessed against any legal or equitable interest of any Owner of any Common Area Lot within the Project and all improvements thereon or against any Owner of any other Lot and all Improvements thereon.

"Reserved Parking Space(s)" – Those parking spaces within Common Parking Areas, if any, which from time to time may be designated by the Operator for the exclusive use of any particular Owner(s), Occupant(s) and Permittees of the Project, as more particularly defined and described in Section 7.2 hereof. Reserved Parking Spaces shall be counted towards the Allocated Parking Spaces for a Lot and shall not exceed five percent (5%) of an Owner's total Allocated Parking Spaces, without the prior written consent of the Operator. Allocated Parking Spaces for each Lot are shown on Exhibit "D" attached hereto.

"Site Plan(s)" – The Site Plan and Conceptual Site Plan attached to this Declaration as **Exhibits "B - 1" and "B-2"**, respectively.

IN WITNESS WHEREOF, Declarant has signed and made this Declaration as of the date first above written.

Declarant

SANTA BARBARA REALTY HOLDING COMPANY, LLC

By: SRG Santa Barbara, LLC, a Delaware limited liability company, Its: Managing member

By: /s/ Russell A. Goodman
Name: Russell A. Goodman
Title: Authorized Member

State of California)
County of Ventura
) ss.

On April 10, 2009, before me, Judy m. Cook, Notary Public in and for said state, personally appeared Russlle A. Goodman, who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature /s/ Judy m. Cook (Seal)

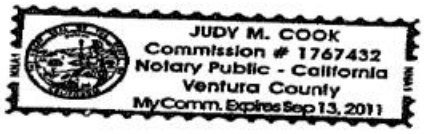


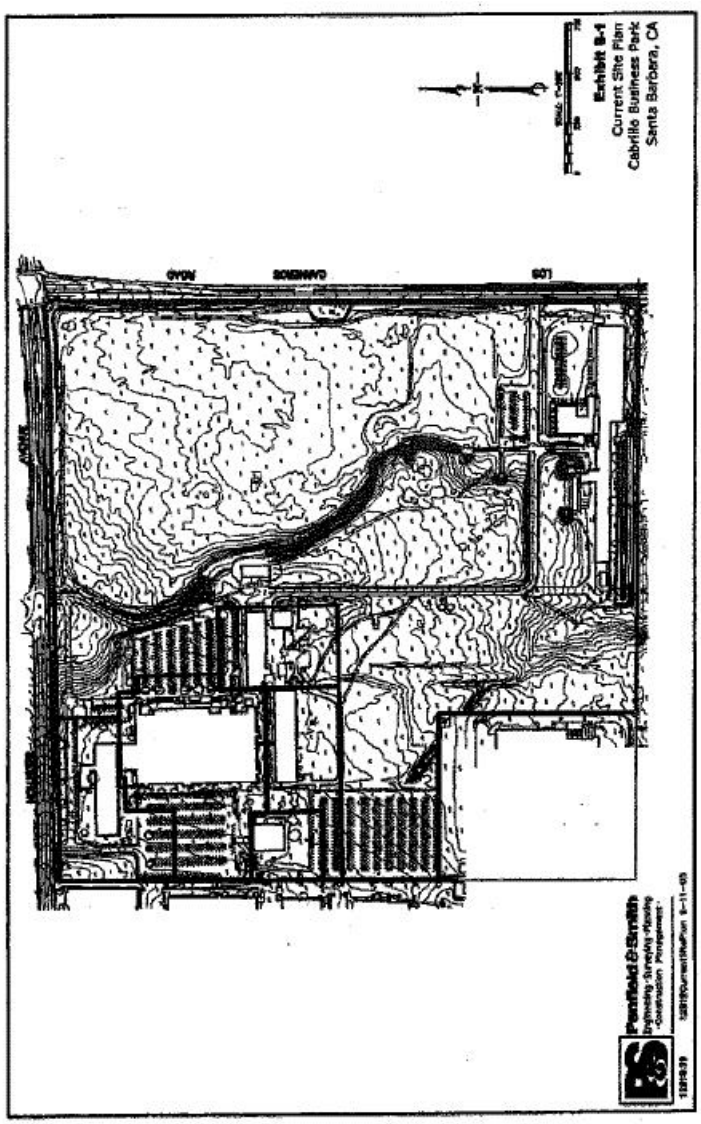
EXHIBIT "A"

Legal Description of Property

That portion of Rancho Los Dos Pueblos, in the City of Goleta, County of Santa Barbara, State of California, described as Parcel One in the deed recorded in the office of the Santa Barbara County Recorder May 31, 1998, as instrument No. 98-020481 of Official Records.

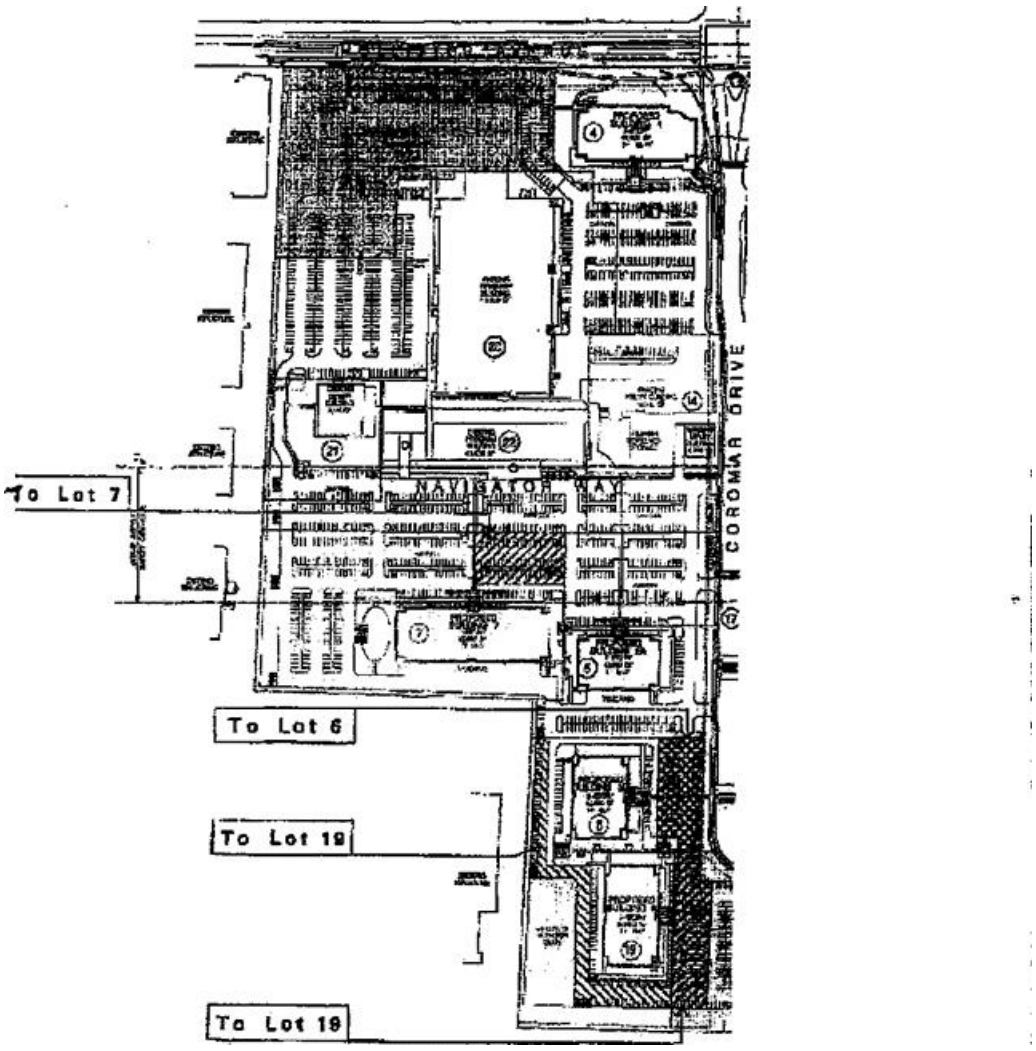
EXHIBIT "B-1"

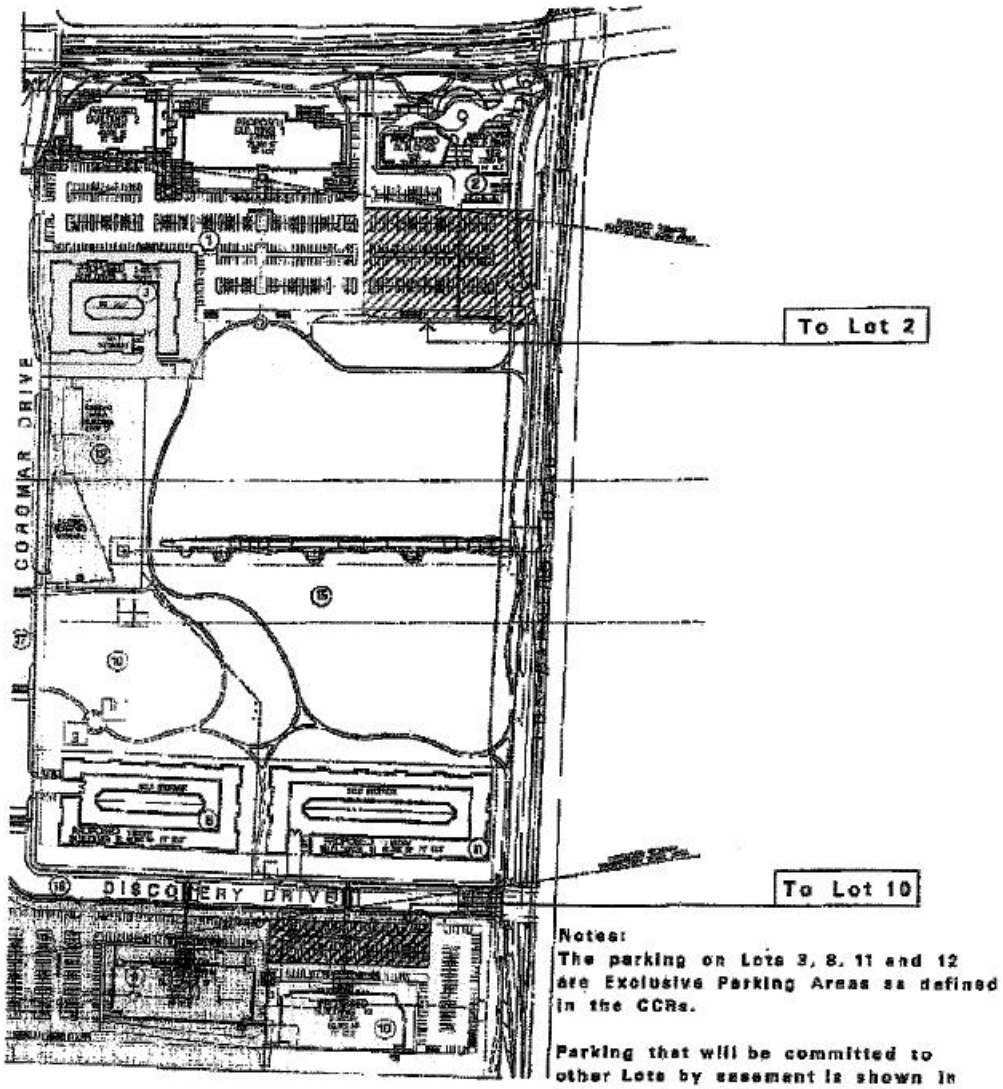
Current Site Plan for the Project as of 1/1/09



EXHIBIT"B-2"

Conceptual Site Plan with Parcel Plan Showing
Potential Full Build-Out of the Project
With Parking on Parcel, including Parking provided by Easement





Notes:
The parking on Lots 3, 8, 11 and 12 are Exclusive Parking Areas as defined in the CCRs.

Parking that will be committed to other Lots by easement is shown in hatch and cross-hatch patterns.

Conceptual Site Plan
Exhibit "B-2"

EXHIBIT"C"

DESCRIPTION OF LOTS: MAXIMUM FLOOR AREAS

"Lot 1" - The land comprising Lot 1 consisting of approximately 9.16 acres of land upon which Declarant contemplates constructing new improvements consisting of two buildings, proposed Building 1 presently contemplated to consist of a two story office building to contain a maximum of 75,000 square feet of Floor Area **("Building 1"),** proposed Building 2 presently contemplated to consist of a two story office building to contain a maximum of 40,000 square feet of Floor Area **("Building 2"),** and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"Lot 2" - The land comprising Lot 2 consisting of approximately 2.33 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of two buildings, a proposed retail building to contain a maximum of 10,000 square feet of Floor Area and a restaurant to contain a maximum of 7,500 square feet of Floor Area **("Building 12a and Building 12b", respectively),** and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 3" - The land comprising Lot 3 consisting of approximately 2.38 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story self storage facility to contain a maximum of 73,500 square feet of Floor Area **("Building 3"**), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B -2"**

"Lot 4" - The land comprising Lot 4 consisting of approximately 3.75 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 60,000 square feet of Floor Area **("Building 4"),** and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B -2"**

"Lot 5" - The land comprising Lot 5 consisting of approximately 5.33 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 40,000 square feet of Floor Area **("Building 5"),** and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B -2"**

"Lot 6" - The land comprising Lot 6 consisting of approximately 3.76 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 40,000 square feet of Floor Area **("Building 6"**), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B -2"**

"Lot 7" - The land comprising Lot 7 consisting of approximately 4.95 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 80,000 square feet of Floor Area **("Building 1"),** and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B -2"**

"Lot 8" - The land comprising Lot 8 consisting of approximately 2.75 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a one story self storage facility to contain a maximum of 46,100 square feet of Floor Area (**"Building 8"**), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B -2"**

"Lot 9" - The land comprising Lot 9 consisting of approximately 5.97 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 70,000 square feet of Floor Area (**"Building 9"**), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B -2"**

"Lot 10" - The land comprising Lot 10 consisting of approximately 2.92 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a two story office building to contain a maximum of 60,000 square feet of Floor Area (**"Building 1"**), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B -2"**

"Lot 11" - The land comprising Lot 11 consisting of approximately 3.13 acres of land upon which Declarant contemplates constructing new improvements presently contemplated to consist of a one story self storage facility to contain a maximum of 55,000 square feet of Floor Area (**"Building 11"**), and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B -2"**

"Lot 12" - The land comprising Lot 12 consisting of approximately 2.32 acres of land upon which is located an approximately 4,007 square foot bond building and existing screened storage area (the **"Lot 12 Improvements"**) comprising the maximum Floor Area for Lot 12, as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 13" - The land comprising Lot 13 consisting of approximately 4.55 acres of land upon which is located an approximately 47,728 square foot administration building (the **"Lot 13 Administration Building"**) comprising the maximum Floor Area for Lot 13, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**

"Lot 14" - The land comprising Lot 14 consisting of approximately 2.96 acres of land upon which is located an approximately 22,000 square foot utility building (**"Building 14"**) comprising the maximum Floor Area for Lot 14, and existing screened storage area and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2"**.

"Lot 15" - of the Project presently contains the land comprising Lot 15 consisting of approximately 15.31 acres of land which is to constitute green belt, buffer area within the Project (the **"Open Space"**) as depicted on the Conceptual Site Plan attached hereto as**Exhibit "B-2"**.

"Lot 16" - of the Project presently contains the land comprising Lot 16 consisting of approximately 3.33 acres of land which is to constitute recreational area within the Project (the **"Recreation Area"**) as depicted on the Conceptual Site Plan attached hereto as**Exhibit "B-2"**.

"Lot 17" - of the Project presently contains the land comprising Lot**17** consisting of approximately 2.35 acres of land which shall comprise an interior private street or streets or portions thereof within the Project as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2".**

"Lot 18" - of the Project presently contains the land comprising Lot**18** consisting of approximately **1.96** acres of land which shall comprise an interior private street or streets or portions thereof within the Project as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2".**

"Lot 19" - of the Project presently contains the land comprising Lot 19 consisting of approximately 1.58 acres of land on which Declarant plans to build an approximately 50,000 square foot building as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2".**

"Lot 20" - The land comprising Lot 20 consisting of approximately 6.87 acres of land upon which is located an approximately 113,330 square foot manufacturing building **("Building 20")** comprising the maximum Floor Area for Lot 20, and related surface parking areas, landscaping and other site, improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2".**

"Lot 21" - The land comprising Lot 21 consisting of approximately 1.49 acres of land upon which is located an approximately 9,141 square foot design building **("Building 21")** comprising the maximum Floor Area for Lot 21, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2".**

"Lot 22" - The land comprising Lot 22 consisting of approximately 3.29 acres of land upon which is located an approximately 45,476 square foot program building **("Building 22")** comprising the maximum Floor Area for Lot 22, and related surface parking areas, landscaping and other site improvements, all as depicted on the Conceptual Site Plan attached hereto as **Exhibit "B-2".**

EXHIBIT "D"

Schedule of Deemed Land Area. Allocated Common Parking Spaces
And Common Area Maintenance Percentages

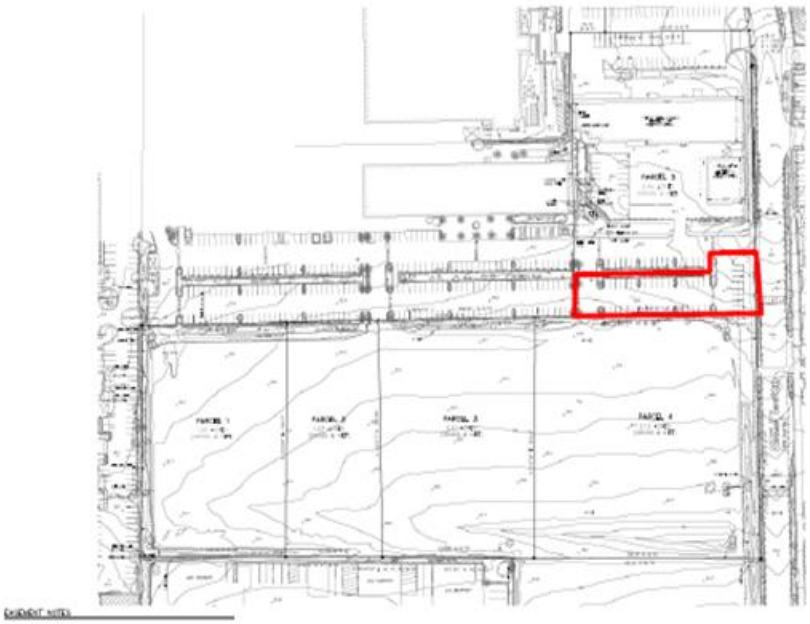
Lot	Building	Maximum Building Square Footage**	Deemed Land Area*	Allocated Parking Spaces**	Parking Ratio — Per 1,000 sq. ft. of Improvements*	Common Expenses Percentage Based on Deemed Land Area
	New Construction					
1	Building 1 & 2	115,000 sf	7.37 acres	344	2.99	10.7%
2	Building 12	17,500 sf	4.41 acres	166	9.49	6.4%
3	Building 3	73,500 sf	2.01 acres	3	0.04	2.9%
4	Building 4	60,000 sf	3.74 acres	181	3.02	5.5%
5	Building 5a	40,000 sf	3.01 acres	123	3.08	4.4%
6	Building 5b	40,000 sf	2.62 acres	125	3.12	3.8%
19	Building 6	50,000 sf	3.99 acres	150	3.00	5.8%
7	Building 7	80,000 sf	5.59 acres	247	3.09	8.2%
8	Building 8	46,100 sf	2.79 acres	6	0.13	4.1%
9	Building 9	70,000 sf	4.65 acres	208	2.97	6.8%
10	Building 10	60,000 sf	3.94 acres	182	3.03	5.7%
11	Building 11	55,000 sf	3.11 acres	3	0.05	4.5%
	Existing Buildings					
12	Bond Building	4,000 sf	2.32 acres	N/A	N/A	3.4%
13	Building 13	47,700 sf	4.27 acres	161	3.37	6.2%
14	Building 14	22,000 sf	2.94 acres	71	3.22	4.3%
20	Building 20	113,300 sf	7.18 acres	337	2.97	10.5%
21	Building 21	9,100 sf	1.51 acres	31	3.44	2.2%
22	Building 22	45,500 sf	3.19 acres	142	3.12	4.6%
	Subtotal		**68.62 net acres**			
15, 16, 17 & 18	Common Area Lots		22.72 acres			
	Dedications		0.91 acres			
	Total	**950,000 sf**	**92.25 acres**	**2480 spaces**	**2.61 avg.**	**100%**

* **Based upon actual Building Lot acreage**, (as set forth on Exhibit "C"), ***plus*** the area of additional land, if any, which is attributable to parking areas allocated for use by the Owner, Occupants and Permittees of such Building Lot by easement from another Building Lot in the Project, and ***less*** the land area, if any, which is located upon such Building Lot and which is allocated by easement for parking use by the Owners, Occupants and Permittees of another Building Lot in the Project

** Based upon permitted/intended use as indicated in the Development Agreement

EXHIBIT D

Site Plan with Additional Parking on Lot 14



AIRCRE

DISCLOSURE REGARDING REAL ESTATE AGENCY RELATIONSHIP
(As required by the Civil Code)

When you enter into a discussion with a real estate agent regarding a real estate transaction, you should from the outset understand what type of agency relationship or representation you wish to have with the agent in the transaction.

SELLER'S AGENT

A Seller's agent under a listing agreement with the Seller acts as the agent for the Seller only. A Seller's agent or a subagent of that agent has the following affirmative obligations:

To the Seller: A fiduciary duty of utmost care, integrity, honesty and loyalty in dealings with the Seller.

To the Buyer and the Seller:

(a) Diligent exercise of reasonable skill and care in performance of the agent's duties.
(b) A duty of honest and fair dealing and good faith.
(c) A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the parties.

An agent is not obligated to reveal to either party any confidential information obtained from the other party that does not involve the affirmative duties set forth above.

BUYER'S AGENT

A Buyer's agent can, with a Buyer's consent, agree to act as agent for the Buyer only. In these situations, the agent is not the Seller's agent, even if by agreement the agent may receive compensation for services rendered, either in full or in part from the Seller. An agent acting only for a Buyer has the following affirmative obligations:

To the Buyer: A fiduciary duty of utmost care, integrity, honesty and loyalty in dealings with the Buyer.

To the Buyer and the Seller:

(a) Diligent exercise of reasonable skill and care in performance of the agent's duties.
(b) A duty of honest and fair dealing and good faith.
(c) A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the parties.

An agent is not obligated to reveal to either party any confidential information obtained from the other party that does not involve the affirmative duties set forth above.

AGENT REPRESENTING BOTH SELLER AND BUYER

A real estate agent, either acting directly or through one or more salesperson and broker associates, can legally be the agent of both the Seller and the Buyer in a transaction, but only with the knowledge and consent of both the Seller and the Buyer.

In a dual agency situation, the agent has the following affirmative obligations to both the Seller and the Buyer:

(a) A fiduciary duty of utmost care, integrity, honesty and loyalty in the dealings with either the Seller or the Buyer.
(b) Other duties to the Seller and the Buyer as stated above in their respective sections.

In representing both Seller and Buyer, a dual agent may not, without the express permission of the respective party, disclose to the other party confidential information, including, but not limited to, facts relating to either the Buyer's or Seller's financial position, motivations, bargaining position, or other personal information that may impact price, including the Seller's willingness to accept a price less than the listing price or the Buyer's willingness to pay a price greater than the price offered.

SELLER AND BUYER RESPONSIBILITIES

Either the purchase agreement or a separate document will contain a confirmation of which agent is representing you and whether that agent is representing you exclusively in the transaction or acting as a dual agent. Please pay attention to that confirmation to make sure it accurately reflects your understanding of your agent's role. The above duties of the agent in a real estate transaction do not relieve a Seller or Buyer from the responsibility to protect his or her own interests. You should carefully read all agreements to assure that they adequately express your understanding of the transaction. A real estate agent is a person qualified to advise about real estate. If legal or tax advice is desired, consult a competent professional. If you are a Buyer, you have the duty to exercise reasonable care to protect yourself, including as to those facts about the property which are known to you or within your diligent attention and observation. Both Sellers and Buyers should strongly consider obtaining tax advice from a competent professional because the federal and state tax consequences of a transaction can be complex and subject to change.

Throughout your real property transaction you may receive more than one disclosure form, depending upon the number of agents assisting in the transaction. The law requires each agent with whom you have more than a casual relationship to present you with this disclosure form. You should read its contents each time it is presented to you, considering the relationship between you and the real estate agent in your specific transaction. **This disclosure form includes the provisions of Sections 2079.13 to 2079.24, inclusive, of the Civil Code set forth on page 2. Read it carefully. I/WE ACKNOWLEDGE RECEIPT OF A COPY OF THIS DISCLOSURE AND THE PORTIONS OF THE CIVIL CODE PRINTED ON THE BACK (OR A SEPARATE PAGE).**

☐	Buyer	☐	Seller	☐	Lessor	☑	Lessee	/s/ Scott Wilkinson	Date:	6/19/19
☐	Buyer	☐	Seller	☑	Lessor	☐	Lessee	/s/ Steven C. Leonard	Date:	6/20/19

Agent: Hayes Commercial Group DRE Lic. #: 0217017
Real Estate Broker (Firm)
By
: /s/ Christos Celmayster DRE Lic. #: 01342996 Date: 6/21/19
(Salesperson or Broker-Associate)

DISCLOSURE REGARDING REAL ESTATE AGENCY RELATIONSHIP
CIVIL CODE SECTIONS 2079.13 THROUGH 2079.24 (2079.16 APPEARS ON THE FRONT)

2079.13. As used in Sections 2079.7 and 2079.14 to 2079.24, inclusive, the following terms have the following meanings:
(a) "Agent" means a person acting under provisions of Title 9 (commencing with Section 2295) in a real property transaction, and includes a person who is licensed as a real estate broker under Chapter 3 (commencing with Section 10130) of Part 1 of Division 4 of the Business and Professions Code, and under whose license a listing is executed or an offer to purchase is obtained. The agent in the real property transaction bears responsibility for that agent's salespersons or broker associates who perform as agents of the agent. When a salesperson or broker associate owes a duty to any principal, or to any buyer or seller who is not a principal, in a real property transaction, that duty is equivalent to the duty owed to that party by the broker for whom the salesperson or broker associate functions. **(b)** "Buyer" means a transferee in a real property transaction, and includes a person who executes an offer to purchase real property from a seller through an agent, or who seeks the services of an agent in more than a casual, transitory, or preliminary manner, with the object of entering into a real property transaction. "Buyer" includes vendee or lessee of real property. **(c)** "Commercial real property" means all real property in the state, except (1) single-family residential real property, (2) dwelling units made subject to Chapter 2 (commencing with Section 1940) of Title 5, (3) a mobile home, as defined in Section 798.3, (4) vacant land, or (5) a recreational vehicle, as defined in Section 799.29. **(d)** "Dual agent" means an agent acting, either directly or through a salesperson or broker associate, as agent for both the seller and the buyer in a real property transaction. **(e)** "Listing agreement" means a written contract between a seller of real property and an agent, by which the agent has been authorized to sell the real property or to find or obtain a buyer, including rendering other services for which a real estate license is required to the seller pursuant to the terms of the agreement. **(f)** "Seller's agent" means a person who has obtained a listing of real property to act as an agent for compensation. **(g)** "Listing price" is the amount expressed in dollars specified in the listing for which the seller is willing to sell the real property through the seller's agent **(h)** "Offering price" is the amount expressed in dollars specified in an offer to purchase for which the buyer is willing to buy the real property **(i)** "Offer to purchase" means a written contract executed by a buyer acting through a buyer's agent that becomes the contract for the sale of the real property upon acceptance by the seller. **(j)** "Real property" means any estate specified by subdivision (1) or (2) of Section 761 in property, and includes (1) single-family residential property, (2) multiunit residential property with more than four dwelling units, (3) commercial real property, (4) vacant land, (5) a ground lease coupled with improvements, or (6) a manufactured home as defined in Section 18007 of the Health and Safety Code, or a mobile home as defined in Section 18008 of the Health and Safety Code, when offered for sale or sold through an agent pursuant to the authority contained in Section 10131.6 of the Business and Professions Code. **(k)** "Real property transaction" means a transaction for the sale of real property in which an agent is retained by a buyer, seller, or both a buyer and seller to act in that transaction, and includes a listing or an offer to purchase. **(l)** "Sell," "sale," or "sold" refers to a transaction for the transfer of real property from the seller to the buyer and includes exchanges of real property between the seller and buyer, transactions for the creation of a real property sales contract within the meaning of Section 2985, and transactions for the creation of a leasehold exceeding one year's duration. **(m)** "Seller" means the transferor in a real property transaction and includes an owner who lists real property with an agent, whether or not a transfer results, or who receives an offer to purchase real property of which he or she is the owner from an agent on behalf of another. "Seller" includes both a vendor and a lessor of real property. **(n)** "Buyer's agent" means an agent who represents a buyer in a real property transaction.

2079.14. A seller's agent and buyer's agent shall provide the seller and buyer in a real property transaction with a copy of the disclosure form specified in Section 2079.16, and shall obtain a signed acknowledgment of receipt from that seller and buyer, except as provided in Section 2079.15, as follows: **(a)** The seller's agent, if any, shall provide the disclosure form to the seller prior to entering into the listing agreement. **(b)** The buyer's agent shall provide the disclosure form to the buyer as soon as practicable prior to execution of the buyer's offer to purchase. If the offer to purchase is not prepared by the buyer's agent, the buyer's agent shall present the disclosure form to the buyer not later than the next business day after receiving the offer to purchase from the buyer.

2079.15 In any circumstance in which the seller or buyer refuses to sign an acknowledgment of receipt pursuant to Section 2079.14, the agent shall set forth, sign, and date a written declaration of the facts of the refusal.

2079.16 Reproduced on Page 1 of this AD form.

2079.17(a) As soon as practicable, the buyer's agent shall disclose to the buyer and seller whether the agent is acting in the real property transaction as the buyer's agent, or as a dual agent representing both the buyer and the seller. This relationship shall be confirmed in the contract to purchase and sell real property or in a separate writing executed or acknowledged by the seller, the buyer, and the buyer's agent prior to or coincident with execution of that contract by the buyer and the seller, respectively. **(b)** As soon as practicable, the seller's agent shall disclose to the seller whether the seller's agent is acting in the real property transaction as the seller's agent, or as a dual agent representing both the buyer and seller. This relationship shall be confirmed in the contract to purchase and sell real property or in a separate writing executed or acknowledged by the seller and the seller's agent prior to or coincident with the execution of that contract by the seller.
(C) CONFIRMATION: The following agency relationships are confirmed for this transaction.

Seller's Brokerage Firm DO NOT COMPLETE, SAMPLE ONLY License Number _____
Is the broker of (check one): □ the seller; or □ both the buyer and seller. (dual agent)

Seller's Agent DO NOT COM

PLETE, SAMPLE ONLY License Number _____
Is (check one): □ the Seller's Agent. (salesperson or broker associate); or □ both the Buyer's Agent and the Seller's Agent. (dual agent)

Buyer's Brokerage Firm DO NOT COMPLETE, SAMPLE ONLY License Number _____
Is the broker of (check one): □ the buyer; or □ both the buyer and seller. (dual agent)

Buyer's Agent DO NOT COMPLETE, SAMPLE ONLY License Number _____
Is (check one): □ the Buyer's Agent. (salesperson or broker associate); or □ both the Buyer's Agent and the Seller's Agent. (dual agent)

(d) The disclosures and confirmation required by this section shall be in addition to the disclosure required by Section 2079.14. An agent's duty to provide disclosure and confirmation of representation in this section may be performed by a real estate salesperson or broker associate affiliated with that broker.

2079.18 (Repealed pursuant to AB-1289, 2017-18 California Legislative session)

2079.19 The payment of compensation or the obligation to pay compensation to an agent by the seller or buyer is not necessarily determinative of a particular agency relationship between an agent and the seller or buyer. A listing agent and a selling agent may agree to share any compensation or commission paid, or any right to any compensation or commission for which an obligation arises as the result of a real estate transaction, and the terms of any such agreement shall not necessarily be determinative of a particular relationship.

2079.20 Nothing in this article prevents an agent from selecting, as a condition of the agent's employment, a specific form of agency relationship not specifically prohibited by this article if the requirements of Section 2079.14 and Section 2079.17 are complied with.

2079.21 (a) A dual agent may not, without the express permission of the seller, disclose to the buyer any confidential information obtained from the seller. **(b)** A dual agent may not, without the express permission of the buyer, disclose to the seller any confidential information obtained from the buyer **(c)** "Confidential information" means facts relating to the client's financial position, motivations, bargaining position, or other personal information that may impact price, such as the seller is willing to accept a price less than the listing price or the buyer is willing to pay a price greater than the price offered. **(d)** This section does not alter in any way the duty or responsibility of a dual agent to any principal with respect to confidential information other than price.

2079.22 Nothing in this article precludes a seller's agent from also being a buyer's agent. If a seller or buyer in a transaction chooses to not be represented by an agent, that does not, of itself, make that agent a dual agent.

2079.23(a) A contract between the principal and agent may be modified or altered to change the agency relationship at any time before the performance of the act which is the object of the agency with the written consent of the parties to the agency relationship. **(b)** A lender or an auction company retained by a lender to control aspects of a transaction of real property subject to this part, including validating the sales price, shall not require, as a condition of receiving the lender's approval of the transaction, the homeowner or listing agent to defend or indemnify the lender or auction company from any liability alleged to result from the actions of the lender or auction company. Any clause, provision, covenant, or agreement purporting to impose an obligation to defend or indemnify a lender or an auction company in violation of this subdivision is against public policy, void, and unenforceable.

2079.24 Nothing in this article shall be construed to either diminish the duty of disclosure owed buyers and sellers by agents and their associate licensees, subagents, and employees or to relieve agents and their associate licensees, subagents, and employees from liability for their conduct in connection with acts governed by this article or for any breach of a fiduciary duty or a duty of disclosure.

Exhibit 31.1

Certification by the Chief Executive Officer Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002

I, Scott Wilkinson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Inogen, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 7, 2019

By: /s/ Scott Wilkinson
Scott Wilkinson
Chief Executive Officer, President and Director
(Principal Executive Officer)

Exhibit 31.2

Certification by the Chief Financial Officer Pursuant to
Section 302 of the Sarbanes-Oxley Act of 2002

I, Alison Bauerlein, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Inogen, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 7, 2019

By: /s/ Alison Bauerlein
Alison Bauerlein
Chief Financial Officer
Executive Vice President, Finance
Secretary and Treasurer
(Principal Financial Officer)

Exhibit 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. § 1350, AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

I, Scott Wilkinson, the chief executive officer of Inogen, Inc. (the "Company"), certify for the purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge,

(i) the Quarterly Report of the Company on Form 10-Q for the three months ended June 30, 2019 (the "Report"), fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

August 7, 2019

By: /s/ Scott Wilkinson
Scott Wilkinson
Chief Executive Officer, President and Director

Exhibit 32.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. § 1350, AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

I, Alison Bauerlein, the chief financial officer of Inogen, Inc. (the "Company"), certify for the purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge,

(i) the Quarterly Report of the Company on Form 10-Q for the three months ended June 30, 2019 (the "Report"), fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

August 7, 2019

By: /s/ Alison Bauerlein
Alison Bauerlein
Chief Financial Officer
Executive Vice President, Finance
Secretary and Treasurer