

GLADSTONE COMMERCIAL CORP

Form 10-K

March 08, 2011

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K**

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

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2010  
OR**

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

**COMMISSION FILE NUMBER: 001-33097  
GLADSTONE COMMERCIAL CORPORATION  
(Exact name of registrant as specified in its charter)**

**MARYLAND**

*(State or other jurisdiction of incorporation or  
organization)*

**02-0681276**

*(I.R.S. Employer Identification No.)*

**1521 WESTBRANCH DRIVE, SUITE 200  
MCLEAN, VIRGINIA 22102**

*(Address of principal executive office)*

**(703) 287-5800**

*(Registrant's telephone number, including area code)*

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

*(Title of Each Class)*

*(Name of exchange on which registered)*

Common Stock, par value \$0.001 per share

NASDAQ Global Select Market

7.75% Series A Cumulative Redeemable Preferred Stock, par value  
\$0.001 per share

NASDAQ Global Select Market

7.50% Series B Cumulative Redeemable Preferred Stock, par value  
\$0.001 per share

NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o  
No þ.

Indicate by check if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  
o No þ.

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 þ No o.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if  
any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes o No o.

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this 10-K or any amendment to this Form 10-K. ☐

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

Large Accelerated Filer ☐

Accelerated Filer ☒

Non-Accelerated Filer ☐

Smaller Reporting  
Company ☐.

(Do not check if smaller  
Reporting Company)

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

The aggregate market value of the voting stock held by non-affiliates of the registrant on June 30, 2010, based on the closing price on that date of \$16.34 on the NASDAQ Global Select Market, was \$130,865,524. For the purposes of calculating this amount only, all directors and executive officers of the registrant have been deemed to be affiliates. The number of shares of the registrant's Common Stock, \$0.001 par value, outstanding as of March 8, 2011 was 9,571,379.

Documents Incorporated by Reference: Portions of the registrant's Proxy Statement relating to the Registrant's 2011 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K.

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**GLADSTONE COMMERCIAL CORPORATION**  
**FORM 10-K FOR THE YEAR ENDED**  
**DECEMBER 31, 2010**  
**TABLE OF CONTENTS**

|                                                                                                                             | PAGE |
|-----------------------------------------------------------------------------------------------------------------------------|------|
| <b><u>PART I</u></b>                                                                                                        |      |
| <u>Item 1. Business</u>                                                                                                     | 4    |
| <u>Item 1A. Risk Factors</u>                                                                                                | 19   |
| <u>Item 1B. Unresolved Staff Comments</u>                                                                                   | 34   |
| <u>Item 2. Properties</u>                                                                                                   | 35   |
| <u>Item 3. Legal Proceedings</u>                                                                                            | 39   |
| <u>Item 4. Removed and Reserved</u>                                                                                         | 39   |
| <b><u>PART II</u></b>                                                                                                       |      |
| <u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 40   |
| <u>Item 6. Selected Financial Data</u>                                                                                      | 42   |
| <u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 44   |
| <u>Item 7A. Quantitative and Qualitative Disclosures about Market Risk</u>                                                  | 63   |
| <u>Item 8. Financial Statements and Supplementary Data</u>                                                                  | 64   |
| <u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | 98   |
| <u>Item 9A. Controls and Procedures</u>                                                                                     | 98   |
| <u>Item 9B. Other Information</u>                                                                                           | 98   |
| <b><u>PART III</u></b>                                                                                                      |      |
| <u>Item 10. Directors, Executive Officers and Corporate Governance</u>                                                      | 99   |
| <u>Item 11. Executive Compensation</u>                                                                                      | 99   |
| <u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>              | 99   |
| <u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>                                   | 99   |

|                                                        |    |
|--------------------------------------------------------|----|
| <u>Item 14. Principal Accountant Fees and Services</u> | 99 |
|--------------------------------------------------------|----|

**PART IV**

|                                                            |     |
|------------------------------------------------------------|-----|
| <u>Item 15. Exhibits and Financial Statement Schedules</u> | 100 |
|------------------------------------------------------------|-----|

EX-21

EX-23

EX-31.1

EX-31.2

EX-32.1

EX-32.2

**Table of Contents**

**Forward-Looking Statements**

Our disclosure and analysis in this Annual Report on Form 10-K, or Form 10-K, and the documents that are incorporated by reference herein contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act. Forward-looking statements provide our current expectations or forecasts of future events and are not statements of historical fact. These forward-looking statements include information about possible or assumed future events, including, among other things, discussion and analysis of our future financial condition, results of operations and funds from operations, or FFO, our strategic plans and objectives, cost management, occupancy and leasing rates and trends, liquidity and ability to refinance our indebtedness as it matures, anticipated capital expenditures (and access to capital) required to complete projects, amounts of anticipated cash distributions to our stockholders in the future and other matters. Words such as anticipates, expects, intends, plans, believes, seeks, estimates and variations of these words and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control, are difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Statements regarding the following subjects, among others, are forward-looking by their nature:

our business and financing strategy;

our ability to implement our business plan;

pending transactions;

our projected operating results;

our ability to obtain future financing arrangements;

estimates relating to our future distributions;

our understanding of our competition and our ability to compete effectively;

market and industry trends;

interest and insurance rates;

estimates of our future operating expenses, including payments to our Adviser (as defined herein) under the terms of our Advisory Agreement (as defined herein);

projected capital expenditures; and

use of the proceeds of our New Line of Credit (as defined herein), mortgage notes payable and other future capital resources, if any.

Forward-looking statements involve inherent uncertainty and may ultimately prove to be incorrect or false. You are cautioned to not place undue reliance on forward-looking statements. Except as otherwise may be required by law, we undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or actual operating results. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including, but not limited to:

the loss of any of our key employees, such as Mr. David Gladstone, our Chairman and Chief Executive Officer, Mr. Terry Lee Brubaker, our Vice Chairman and Chief Operating Officer, or Mr. George Stelljes III, our President and Chief Investment Officer;



**Table of Contents**

general volatility of the capital markets and the market price of our common and preferred stock;

risks associated with negotiation and consummation of pending and future transactions;

changes in our business strategy;

the adequacy of our cash reserves and working capital;

our failure to successfully integrate and operate acquired properties and operations;

defaults upon or non-renewal of leases by tenants;

decreased rental rates or increased vacancy rates;

the degree and nature of our competition;

availability, terms and deployment of capital, including the ability to maintain and borrow under our New Line of Credit, arrange for long-term mortgages on our properties, secure one or more additional long-term lines of credit and raise equity capital;

our ability to identify, hire and retain highly-qualified personnel in the future;

changes in our industry or the general economy;

changes in real estate and zoning laws and increases in real property tax rates;

changes in governmental regulations, tax rates and similar matters; and

environmental uncertainties and risks related to natural disasters.

This list of risks and uncertainties, however, is only a summary of some of the most important factors to us and is not intended to be exhaustive. You should carefully review the risks set forth herein under the caption Item 1A. Risk Factors. New factors may also emerge from time to time that could materially and adversely affect us.

**Item 1. Business**

**Overview**

Gladstone Commercial Corporation (which we refer to as we, us, or the Company, ) is a real estate investment trust, or REIT, that was incorporated under the General Corporation Laws of the State of Maryland on February 14, 2003 primarily for the purpose of investing in and owning net leased industrial and commercial real property and selectively making long-term industrial and commercial mortgage loans. Most of our portfolio of real estate we currently own is leased to a wide cross section of tenants ranging from small businesses to large public companies, many of which are corporations that do not have publicly rated debt. We have in the past entered into, and intend in the future to enter into, purchase agreements for real estate having triple net leases with terms of approximately 10 to 15 years and built in rental increases. Under a triple net lease, the tenant is required to pay all operating, maintenance and insurance costs and real estate taxes with respect to the leased property. We currently own a total of 65 properties.

We conduct substantially all of our activities, including the ownership of all of our properties, through Gladstone Commercial Limited Partnership, a Delaware limited partnership, which we refer to as our Operating Partnership. We control our Operating Partnership through our ownership of GCLP Business Trust II, a Massachusetts business trust, which is the general partner of our Operating Partnership, and of

## **Table of Contents**

GCLP Business Trust I, a Massachusetts business trust, which currently holds all of the limited partnership units of our Operating Partnership. We expect that our Operating Partnership may issue limited partnership units from time to time in exchange for industrial and commercial real property. Limited partners who hold limited partnership units in our Operating Partnership will be entitled to redeem these units for cash or, at our election, shares of our common stock on a one-for-one basis at any time.

Our Operating Partnership is also the sole member of Gladstone Commercial Lending, LLC, which we refer to as Gladstone Commercial Lending. Gladstone Commercial Lending is a Delaware limited liability company that was formed to hold all of our real estate mortgage loans.

### **Our Investment Objectives and Our Strategy**

Our principal investment objectives are to generate income from rental properties and, to a much lesser extent, mortgage loans, which we use to fund our continuing operations and to pay out monthly cash distributions to our stockholders. We intend to grow the distribution to stockholders over time, and to increase the value of our common stock. Our primary strategy to achieve our investment objectives is to invest in and own a diversified portfolio of leased industrial and commercial real estate that we believe will produce stable cash flow and increase in value. We expect to sell some of our real estate assets from time to time when our Adviser determines that doing so would be advantageous to us and our stockholders. We also expect to occasionally make mortgage loans secured by income-producing commercial or industrial real estate, which loans may have some form of equity participation. As of December 21, 2010, we had no investments in mortgage loans.

Our strategy includes the use of leverage so that we may make more investments than would otherwise be possible in order to maximize potential returns to stockholders. We are not limited with respect to the amount of leverage that we may use for the acquisition of any specific property. We intend to use non-recourse mortgage financing that will allow us to limit our loss exposure on any property to the amount of equity invested in such property. However, the market for long-term mortgages has been limited, as the collateralized mortgage-backed securities, or CMBS, market has experienced significant disruption. With the stresses upon the CMBS market, many banks are not lending on industrial and commercial real estate as they are no longer able to sell these loans to the CMBS market and are not willing or able to keep these loans on their balance sheets. In addition, many banks have significantly curtailed their general lending practices, as they are having difficulty valuing the underlying real estate in this market. We are, however, beginning to see banks that are willing to issue medium-term mortgages, between two and five years, on substantially less favorable terms than were previously available. Consequently, we continue to focus on using medium-term mortgages to finance our real estate activities until the market for long-term mortgages returns.

### **Investment Policies and Policies with Respect to Certain Activities**

#### ***Types of Investments***

##### ***Overview***

We intend that substantially all of our investments will be generated from the ownership of income-producing real property or, to a much lesser extent, mortgage loans secured by real property. We expect that the vast majority of our investments will be structured as net leases, but if a net lease would have an adverse impact on a potential tenant, or would otherwise be inappropriate for us, we may structure our investment as a mortgage loan. Investments are not restricted to geographical areas, but we expect that most of our investments in real estate will be made within the continental United States. Some of our investments may also be made through joint ventures that would permit us to own interests in large properties without restricting the diversity of our portfolio. Our stockholders are not afforded the opportunity to evaluate the economic merits of our investments or the terms of any dispositions of properties. See

*Risk Factors* Our success depends on the performance of our Adviser, and, if our Adviser

**Table of Contents**

*makes inadvisable investment or management decisions, our operations could be materially adversely impacted.*

We anticipate that we will make substantially all of our investments through our Operating Partnership and Gladstone Commercial Lending. Our Operating Partnership and Gladstone Commercial Lending may acquire interests in real property or mortgage loans in exchange for the issuance of limited partnership units, for cash or through a combination of both. Units issued by our Operating Partnership generally will be redeemable for cash or, at our election, shares of our common stock on a one-for-one basis. However, we may in the future also conduct some of our business and hold some of our interests in real properties or mortgage loans through one or more wholly-owned subsidiaries that are not owned, directly or indirectly, through our Operating Partnership.

*Property Acquisitions and Net Leasing*

To date, a majority of our properties have been purchased from owners that have leased their properties to non-affiliated tenants, and while we have engaged in some transactions with tenants who have consummated sale-leaseback transactions, these transactions do not comprise the dominant portion of our portfolio. We expect that some of our sale-leaseback transactions will be in conjunction with acquisitions, recapitalizations or other corporate transactions affecting our tenants. In these transactions, we may act as one of several sources of financing for these transactions by purchasing one or more properties from the tenant and by net leasing it to the tenant or its successor in interest. For a discussion of the risks associated with leasing property to leveraged tenants, see *Risk Factors Highly leveraged tenants or borrowers may be unable to pay rent or make mortgage payments, which could adversely affect our cash available to make distributions to our stockholders.*

In limited circumstances, we have granted tenants an option to purchase the leased property, and we anticipate granting these options to select tenants in the future. In these cases, we generally seek to fix the option purchase price at the greater of our purchase price for the property and the fair market value of the property at the time the option is exercised.

Our portfolio consists primarily of single-tenant commercial and industrial real property; however, we also consider multi-tenant commercial and industrial properties, as well as retail and medical properties. Generally, we lease properties to tenants that our Adviser deems creditworthy under leases that will be full recourse obligations of our tenants or their affiliates. In most cases, our leases will be triple net leases that require the tenant to pay all the operating costs, costs of maintenance, insurance and real estate taxes on the property. We seek to obtain lease terms of approximately 10 to 15 years with built-in rental increases.

*Investments in Mortgage Loans*

Although we expect such investments to be made sparingly, we may elect to structure our investment in a particular property as a mortgage loan secured by the property in situations where a standard net lease transaction would have an adverse tax impact on the seller of a property or would otherwise be inappropriate for us. We anticipate that most of our lending transactions will be loans secured by industrial or commercial property. Our Adviser will attempt to structure mortgage loans in a manner that would provide us with current income substantially similar to that which we could expect to receive had the investment been structured as a net lease transaction.

To the extent that we invest in mortgage loans, we will generally originate those loans. However, we may also purchase mortgage loans from banks, CMBS pools, or other lenders if such transactions are consistent with our investment objectives. Our Adviser will service the mortgage loans in our portfolio by monitoring the collection of monthly principal and interest payments on our behalf. There were no mortgage loans outstanding as of December 31, 2010.

**Table of Contents**

***Underwriting Criteria, Due Diligence Process and Negotiating Lease Provisions***

We consider underwriting of the real estate and the tenant for the property (or the borrower in the case of a mortgage loan) to be the most important aspects of making an investment. Evaluating the creditworthiness of the tenant or borrower and its ability to generate sufficient cash flow to make payments to us pursuant to the lease or the mortgage loan is the most important aspect of our underwriting procedures. In analyzing potential acquisitions of properties and leases, our Adviser reviews all aspects of the potential transaction, including tenant and real estate fundamentals, to determine whether potential acquisitions and leases can be structured to satisfy our acquisition criteria. The criteria listed below provide general guideposts that our Adviser may consider when underwriting leases and mortgage loans:

*Credit Evaluation.* Our Adviser evaluates each potential tenant for its creditworthiness, considering factors such as management experience, industry position and fundamentals, operating history and capital structure. A prospective tenant that is deemed creditworthy does not necessarily mean that we will consider the tenant's property to be investment grade. Our Adviser seeks tenants that range from small businesses, many of which do not have publicly rated debt, to large public companies. Our Adviser's investment professionals have substantial experience in locating and financing these types of companies. By leasing properties to these tenants, we believe that we will generally be able to charge rent that is higher than the rent charged to tenants with unleveraged balance sheets and recognized credit, thereby enhancing current return from these properties as compared with properties leased to companies whose credit potential has already been recognized by the market. Furthermore, if a tenant's credit does improve, the value of our lease or investment will likely increase (if all other factors affecting value remain unchanged). In evaluating a possible investment, we believe that the creditworthiness of a prospective tenant is normally a more significant factor than the unleased value of the property itself. While our Adviser selects tenants it believes to be creditworthy, tenants are not required to meet any minimum rating established by an independent credit rating agency. Our Adviser's standards for determining whether a particular tenant is creditworthy vary in accordance with a variety of factors relating to specific prospective tenants. The creditworthiness of a tenant is determined on a tenant by tenant and case by case basis. Therefore, general standards for creditworthiness cannot be applied.

*Leases with Increasing Rent.* Our Adviser seeks to include a clause in each lease that provides for annual rent escalations over the term of the lease. These increases will generally be fixed; however certain leases are tied to increases in indices such as the consumer price index.

*Diversification.* Our Adviser attempts to diversify our portfolio to avoid dependence on any one particular tenant, facility type, geographic location or tenant industry. By diversifying our portfolio, our Adviser intends to reduce the adverse effect on our portfolio of a single under-performing investment or a downturn in any particular industry or geographic region. Total rental income consisted of the following tenant industry classifications as of December 31, 2010 and December 31, 2009:

**Table of Contents**

|                                          | <b>December 31, 2010</b> |                  | <b>December 31, 2009</b> |                  |
|------------------------------------------|--------------------------|------------------|--------------------------|------------------|
|                                          |                          | Percentage<br>of |                          | Percentage<br>of |
| Industry Classification                  | Rental<br>Income         | Rental<br>Income | Rental<br>Income         | Rental<br>Income |
| Electronics                              | \$ 6,165,788             | 15.0%            | \$ 6,164,789             | 14.9%            |
| Healthcare, Education & Childcare        | 6,145,415                | 14.9%            | 6,145,415                | 14.8%            |
| Telecommunications                       | 5,447,365                | 13.3%            | 5,447,033                | 13.1%            |
| Diversified/Conglomerate Manufacturing   | 3,664,686                | 8.9%             | 3,664,686                | 8.8%             |
| Chemicals, Plastics & Rubber             | 3,130,133                | 7.6%             | 3,173,514                | 7.6%             |
| Machinery                                | 2,332,672                | 5.7%             | 2,389,607                | 5.8%             |
| Containers, Packaging & Glass            | 2,330,715                | 5.7%             | 2,330,246                | 5.6%             |
| Beverage, Food & Tobacco                 | 2,188,793                | 5.2%             | 2,188,755                | 5.3%             |
| Printing & Publishing                    | 2,187,504                | 5.3%             | 2,189,033                | 5.3%             |
| Buildings and Real Estate                | 2,075,103                | 5.0%             | 2,025,668                | 4.9%             |
| Oil & Gas                                | 1,282,582                | 3.1%             | 1,138,136                | 2.7%             |
| Personal & Non-Durable Consumer Products | 1,228,100                | 2.9%             | 1,354,721                | 3.3%             |
| Automobile                               | 1,166,654                | 2.8%             | 1,166,654                | 2.8%             |
| Personal, Food & Miscellaneous Services  | 575,006                  | 1.4%             | 575,006                  | 1.4%             |
| Home & Office Furnishings                | 529,743                  | 1.3%             | 529,743                  | 1.3%             |
| Insurance                                | 421,672                  | 1.0%             | 722,866                  | 1.7%             |
| Diversified/Conglomerate Services        | 308,105                  | 0.9%             | 308,105                  | 0.7%             |
|                                          | \$ 41,180,036            | 100.0%           | \$ 41,513,977            | 100.0%           |

*Property Valuation.* The business prospects and the financial strength of the tenant are important aspects of the evaluation of any sale and leaseback of property, or acquisition of property subject to a net lease, particularly a property that is specifically suited to the needs of the tenant. We generally require quarterly unaudited and annual audited financial statements of the tenant in order to continuously monitor the financial performance of the property. We evaluate the financial capability of the tenant and its ability to perform per the terms of the lease. We may also examine the available operating results of prospective investment properties to determine whether or not projected rental levels are likely to be met. We then compute the value of the property based on historical and projected operating results. In addition, each property that we propose to purchase will be appraised by an independent appraiser. These appraisals may take into consideration, among other things, the terms and conditions of the particular lease transaction, the quality of the tenant's credit and the conditions of the credit markets at the time the lease transaction is negotiated. The appraised value may be greater than the construction cost or the replacement cost of a property, and the actual sale price of a property, if we resell the property in the future, may be greater or less than its appraised value. We generally limit our property acquisition cost or value to between \$3 million and \$30 million.

*Properties Important to Tenant Operations.* Our Adviser generally seeks to acquire investment properties that are essential or important to the ongoing operations of the prospective tenant. We believe that these investment properties provide better protection in the event a tenant becomes bankrupt, as leases on properties essential or important to the operations of a bankrupt tenant are typically less likely to be rejected in the bankruptcy or otherwise terminated.

*Lease Provisions that Enhance and Protect Value.* When appropriate, our Adviser attempts to include provisions in our leases that require our consent to specified tenant activity or require the tenant to satisfy specific operating

tests. These provisions may include, for example, operational or financial covenants of the tenant, as well as indemnification of us by the tenant against environmental and other contingent liabilities. We believe that these provisions serve to protect our investments from changes in the operating and financial characteristics of a tenant that may impact its ability to satisfy its obligations to us or that could reduce the value of our properties. We generally also seek covenants requiring tenants to receive our consent prior to any change in control of the tenant.

*Credit Enhancement.* Our Adviser may also seek to enhance the likelihood of a tenant's lease obligations being satisfied through a cross-default with other tenant obligations, a letter of credit or a guaranty of lease obligations from each tenant's corporate parent. We believe that this type of credit enhancement, if obtained, provides us with additional financial security.

*Underwriting of the Real Estate and Due Diligence Process*

## **Table of Contents**

In addition to underwriting the tenant or borrower, we also underwrite the real estate to be acquired or secured by one of our mortgages. On our behalf, our Adviser performs a due diligence review with respect to each property, such as evaluating the physical condition of a property, zoning and site requirements to ensure the property is in conformance with all zoning regulations as well as an environmental site assessment, in an attempt to determine potential environmental liabilities associated with a property prior to its acquisition, although there can be no assurance that hazardous substances or wastes (as defined by present or future federal or state laws or regulations) will not be discovered on the property after we acquire it. See *Risk Factors Potential liability for environmental matters could adversely affect our financial condition.*

Our Adviser also reviews the structural soundness of the improvements on the property and may engage a structural engineer to review all aspects of the structures in order to determine the longevity of each building on the property. This review normally also includes the components of each building, such as the roof, the electrical wiring, the heating and air-conditioning system, the plumbing, parking lot and various other aspects such as compliance with state and federal building codes.

Our Adviser also physically inspects the real estate and surrounding real estate as part of determining the value of the real estate. All of our Adviser's due diligence is aimed at arriving at a valuation of the real estate under the assumption that it was not rented to the tenant that we are considering. As part of this process, our Adviser may consider one or more of the following items:

The comparable value of similar real estate in the same general area of the prospective property. In this regard, comparable property is difficult to define because each piece of real estate has its own distinct characteristics. But to the extent possible, comparable property in the area that has sold or is for sale will be used to determine if the price to be paid for the property is reasonable. The question of comparable properties' sale prices is particularly relevant if a property might be sold by us at a later date.

The comparable real estate rental rates for similar properties in the same area of the prospective property.

Alternative property uses that may offer higher value.

The cost of replacing the property if it were to be sold.

The assessed value as determined by the local real estate taxing authority.

In addition, our Adviser supplements its valuation with a real estate appraisal in connection with each investment that we consider. When appropriate, our Adviser may engage experts to undertake some or all of the due diligence efforts described above.

### ***Additional Investment Considerations***

#### ***Terms of Mortgage Loans***

Some of the mortgage loans that we may make, purchase or otherwise acquire in the future, in addition to providing for base interest at a fixed or variable rate, may allow us to participate in the economic benefits of any increase in the value of the property securing repayment of the loan as though we were an equity owner of a portion of the property. In addition, it is possible that participation may take other forms where our Adviser deems participation available or otherwise appropriate, provided that such participation does not jeopardize our REIT tax status. The form and extent of our participation, if any, will vary with each transaction depending on factors such as credit support provided by the borrower, the interest rate on our mortgage loans and the anticipated and actual cash flow from the underlying real property. Our mortgage loans may include first mortgage loans, leasehold mortgage loans or conventional mortgage loans without

**Table of Contents**

equity enhancements. We have not in the past, nor do we intend in the future to make or invest in sub-prime mortgage loans.

Except as described below, any mortgage loan in our portfolio will generally be secured by real property with a demonstrable income-producing potential as well as a security interest in personal or mixed property connected with the real property.

In the event that we make or invest in a mortgage loan, we will generally require a mortgagee's title insurance policy or commitment as to the lien priority of a mortgage or the condition of title in connection with each mortgage loan. We also may obtain an independent appraisal for underlying real property, that our Adviser may consider when determining whether or not to make or invest in a particular mortgage loan. In making mortgage loans that, when combined with existing loans that are on a parity with or senior to our mortgage loan, exceed 85% of the appraised value of any underlying real property, our Adviser considers additional underwriting criteria such as the net worth of the borrower, the borrower's credit rating, if any, the anticipated cash flow of the borrower, any additional collateral or other credit enhancements provided by the borrower or its affiliates and other factors our Adviser deems appropriate. Where we think it is appropriate, we may make mortgage loans that are subordinated to a first mortgage on a property. For example, if the property is subject to an economic development loan as a first mortgage at a particularly low interest rate, we may make a second mortgage loan on the property. However, we will not make a second mortgage loan on any property that we would not consider owning, subject to the existing senior financing, and leasing to the tenant.

From time to time, we may purchase mortgage loans, including loans being sold at a discount, from banks and other financial institutions if the subject property otherwise satisfies our underwriting criteria.

***Other Investments***

Under IRS REIT rules, we may invest up to an aggregate of 10% of our net equity in unimproved or non-income-producing real property and in equity interests. Equity interests are defined generally to mean stock, warrants or other rights to purchase the stock of, or other equity interests in, a tenant of a property, an entity to which we lend money or a parent or controlling person of a borrower or tenant, and we will not acquire equity interests in any entity other than in connection with a lease or mortgage loan transaction. We anticipate that equity interests will not exceed 5% of our net equity in the aggregate, and we will not make any such investment in equity interests if such investment would adversely affect our qualification as a REIT for tax purposes. To the extent that we hold equity interests in tenants or borrowers, we anticipate that they will generally be restricted securities as defined in Rule 144 under the Securities Act. Under this rule, we may be prohibited from reselling the equity securities without limitation until we have fully paid for and held any such securities for one year. The issuer of equity interests, in which we invest, may never register these interests under the federal securities laws, since any decision of an issuer to register its securities may depend on any number of factors, including the success of its operations.

We will generally invest in unimproved or non-income-producing property only when our Adviser believes that such property will appreciate in value or will increase the value of an adjoining or neighboring property that we own. We might use taxable REIT subsidiaries to acquire or hold property, including equity interests that may not be deemed to be REIT-qualified assets. Taxable REIT subsidiaries are taxed as ordinary corporations and any taxes paid by such entity will reduce cash available to us for payment of distributions to our stockholders.

***Joint Ventures***

In the future, we may also enter into joint ventures, partnerships and other mutual arrangements with real estate developers, property owners and others for the purpose of obtaining an equity interest in a property

**Table of Contents**

in accordance with our investment policies. Joint venture investments could permit us to own interests in large properties without unduly restricting the diversity of our portfolio. We will not enter into a joint venture to make an investment that we would not otherwise be permitted to make on our own.

***Use of Leverage***

***Non-recourse Financing***

Our strategy is to use long-term mortgage borrowings as a financing mechanism in amounts that we believe will maximize the return to our stockholders. As discussed above in *Our Investment Objectives and Our Strategy*, long-term mortgages are currently unavailable to us, and we will focus on medium-term mortgages until the market returns. Currently, all of our long-term mortgage borrowings are structured as non-recourse to us, and we intend to structure any medium-term mortgages in the same manner, with limited exceptions that would trigger recourse to us only upon the occurrence of certain fraud, misconduct, environmental or bankruptcy events. The use of non-recourse financing allows us to limit our exposure to the amount of equity invested in the properties pledged as collateral for our borrowings. Non-recourse financing generally restricts a lender's claim on the assets of the borrower, and as a result, the lender generally may look only to the property securing the debt for satisfaction of the debt. We believe that this financing strategy, to the extent available, protects our other assets. However, we can provide no assurance that non-recourse financing will be available on terms acceptable to us, or at all, and there may be circumstances where lenders have recourse to our other assets. There is no limitation on the amount we may borrow against any single investment property.

We believe that, by operating on a leveraged basis, we will have more funds available and, therefore, will make more investments than would otherwise be possible if we operated on a non-leveraged basis. We believe that this creates a more diversified portfolio and maximizes potential returns to our stockholders. We may refinance properties during the term of a loan when we believe it is advantageous.

***Recourse Financing***

Borrowings under our \$50.0 million line of credit, which is secured by those properties pledged to the borrowing base under the line of credit are considered recourse financing, which means that our lenders have a claim against our assets. We intend to use our existing line of credit as a warehouse line of credit whereby we borrow on a short-term basis until long-term financing can be arranged.

***Other Investment Policies***

***Working Capital Reserves***

We may establish a working capital reserve, which we would anticipate to be sufficient to satisfy our liquidity requirements. Our liquidity could be adversely affected by unanticipated costs, greater-than-anticipated operating expenses or cash shortfalls in funding our distributions to stockholders. To the extent that the working capital reserve is insufficient to satisfy our cash requirements, additional funds may be produced from cash generated from operations or through short-term borrowings. In addition, subject to limitations described in this Form 10-K, we may incur indebtedness in connection with:

the acquisition of any property;

the refinancing of the debt upon any property; or

the leveraging of any previously unleveraged property.

**Table of Contents**

For additional information regarding our borrowing strategy, see *Investment Policies and Policies with Respect to Certain Activities Use of Leverage*.

*Holding Period for and Sale of Investments; Reinvestment of Sale Proceeds*

We intend to hold each property we acquire for an extended period. However, circumstances might arise which could result in the early sale of some properties if, in the judgment of our Adviser, the sale of the property is in the best interests of us and our stockholders.

The determination of whether a particular property should be sold or otherwise disposed of will be made after consideration of all relevant factors, including prevailing economic conditions, with a view to achieving maximum capital appreciation. The selling price of a property which is subject to a net lease will be determined in large part by the amount of rent payable under the lease, the remaining term of the lease, and the creditworthiness of the tenant. In connection with our sales of properties, we may lend the purchaser all or a portion of the purchase price. In these instances, our taxable income may exceed the cash received by us in connection with any such sale, which could cause us to delay required distributions to our stockholders.

The terms of any sale will be dictated by custom in the area in which the property being sold is located and the then-prevailing economic conditions. A decision to provide financing to any purchaser would be made only after an investigation into and consideration of the same factors regarding the purchaser, such as creditworthiness and likelihood of future financial stability, as are undertaken when we consider a net lease or mortgage loan transaction. We may continually reinvest the proceeds of property sales in investments that either we or our Adviser believe will satisfy our investment policies.

*Investment Limitations*

There are numerous limitations on the manner in which we may invest our funds, which unless otherwise noted below, may be amended or waived by the Board of Directors at anytime. The Board of Directors has adopted a policy that we will not:

invest in real property owned by our Adviser, any of its affiliates or any business in which our Adviser or any of its subsidiaries have invested except that we may lease property to existing and prospective portfolio companies of current or future affiliates, such as Gladstone Capital Corporation, Gladstone Investment Corporation and entities advised by our Adviser, so long as that entity does not control the portfolio company and the transaction is approved by both companies' board of directors (this policy may not be changed without the approval of our stockholders);

invest in commodities or commodity futures contracts, with this limitation not being applicable to futures contracts when used solely for the purpose of hedging in connection with our ordinary business of investing in properties and making mortgage loans;

invest in contracts for the sale of real estate unless the contract is appropriately recorded in the chain of title;

invest in any individual property with a cost in excess of 20% of our total assets at the time of investment;

make investments in unimproved property or indebtedness secured by a deed of trust or mortgage loans on unimproved property in excess of 10% of our total assets. Unimproved real property is property which has the following three characteristics:

**Table of Contents**

the property was not acquired for the purpose of producing rental or other operating income;

no development or construction is in process on the property; and

no development or construction on the property is planned in good faith to commence on the property within one year of acquisition;

issue equity securities on a deferred payment basis or other similar arrangement;

issue debt securities in the absence of adequate cash flow to cover debt service;

issue redeemable securities as defined in Section 2(a)(32) of the Investment Company Act of 1940;

grant warrants or options to purchase shares of our stock to our Adviser or its affiliates;

engage in trading, as compared with investment activities, or engage in the business of underwriting, or the agency distribution of, securities issued by other persons;

acquire securities in any company holding investments or engaging in activities prohibited in the foregoing clauses; or

make or invest in mortgage loans that are subordinate to any mortgage or equity interest of any of our affiliates.

***Conflict of Interest Policy***

We have adopted policies to reduce potential conflicts of interest. In addition, our directors are subject to certain provisions of Maryland law that are designed to minimize conflicts. However, we cannot assure you that these policies or provisions of law will reduce or eliminate the influence of these conflicts.

Under our current conflict of interest policy, without the approval of a majority of our disinterested directors, we will not:

acquire from or sell to any of our officers, directors or our Adviser's employees, or any entity in which any of our officers, directors or employees has an interest of more than 5%, any assets or other property;

borrow from any of our directors, officers or employees, or any entity, in which any of our officers, directors or employees has an interest of more than 5% or;

engage in any other transaction with any of our directors, officers or employees, or any entity in which any of our directors, officers or employees has an interest of more than 5% (except that our Adviser may lease office space in a building that we own, provided that the rental rate under the lease is determined by our independent directors to be at a fair market rate).

Our policy also prohibits us from purchasing any real property owned by or co-investing with our Adviser, any of its affiliates or any business in which our Adviser or any of its subsidiaries have invested, except that we may lease property to existing and prospective portfolio companies of current or future affiliates, such as Gladstone Capital Corporation or Gladstone Investment Corporation and other entities advised by our Adviser, so long as that entity does not control the portfolio company and the transaction is approved by both companies' board of directors. If we decide to change this policy on co-investments with our Adviser or its affiliates, we will seek our stockholders approval.

**Table of Contents**

***Future Revisions in Policies and Strategies***

Our independent directors periodically review our investment policies to evaluate whether they are in the best interests of us and our stockholders. Our investment procedures, objectives and policies may vary as new investment techniques are developed or as regulatory requirements change, and except as otherwise provided in our charter or bylaws, may be altered by a majority of our directors (including a majority of our independent directors) without the approval of our stockholders, to the extent that our board of directors determines that such modification is in the best interest of our stockholders. Among other factors, developments in the market which affect the policies and strategies described in this report or which change our assessment of the market may cause our board of directors to revise our investment policies and strategies.

***Our Adviser and Administrator***

Our business is managed by our Adviser. The officers, directors and employees of our Adviser have significant experience in making investments in and lending to businesses of all sizes, including investing in real estate and making mortgage loans. We have entered into the Advisory Agreement (as defined below) with our Adviser under which our Adviser is responsible for managing our assets and liabilities, for operating our business on a day-to-day basis and for identifying, evaluating, negotiating and consummating investment transactions consistent with our investment policies as determined by our board of directors from time to time. Our Administrator employs our chief financial officer, chief compliance officer, internal counsel, treasurer, investor relations and their respective staffs. David Gladstone, our chairman and chief executive officer, is also the chairman, chief executive officer and the controlling stockholder of our Adviser. Terry Lee Brubaker, our vice chairman, secretary and chief operating officer and a member of our board of directors, also serves in the same capacities for our Adviser. George Stelljes III, our president and chief investment officer and a member of our board of directors, also serves in the same capacities for our Adviser.

Our Adviser maintains an investment committee that approves each of our investments. This investment committee is comprised of Messrs. Gladstone, Brubaker and Stelljes. We believe that our Adviser's investment committee review process gives us a unique competitive advantage over other REITs because of the substantial experience and perspective that the members possess in evaluating the blend of corporate credit, real estate and lease terms that combine to provide an acceptable risk for our investments.

Our Adviser's board of directors has empowered its investment committee to authorize and approve our investments, subject to the terms of the advisory agreement. Before we acquire any property, the transaction is reviewed by our Adviser's investment committee to ensure that, in its view, the proposed transaction satisfies our investment criteria and is within our investment policies. Approval by our Adviser's investment committee is generally the final step in the property acquisition approval process, although the separate approval of our board of directors is required in certain circumstances described below. For further detail on this process, please see *Underwriting Criteria, Due Diligence Process and Negotiating Lease Provisions*.

Our Adviser is headquartered in McLean, Virginia, a suburb of Washington D.C., and also has offices in New York, Connecticut, Illinois, Texas and Georgia.

***Investment Advisory and Administration Agreements***

Many of the services performed by our Adviser and Administrator in managing our day-to-day activities are summarized below. This summary is provided to illustrate the material functions which our Adviser and Administrator perform for us pursuant to the terms of the Advisory and Administration Agreements (as defined below), respectively, but it is not intended to include all of the services which may be provided to us by third parties.

**Table of Contents**

*Investment Advisory Agreement*

We have an advisory agreement with our Adviser, or the Advisory Agreement, and an administration agreement with our Administrator, or the Administration Agreement.

Under the terms of the Advisory Agreement, we are responsible for all expenses incurred for our direct benefit. Examples of these expenses include legal, accounting, interest on short-term debt and mortgages, tax preparation, directors and officers insurance, stock transfer services, stockholder-related fees, consulting and related fees. All of these charges are incurred directly by us rather than by our Adviser for our benefit. Accordingly, we did not make any reimbursements to our Adviser for these amounts.

In addition, we are also responsible for all fees charged by third parties that are directly related to our business, which may include real estate brokerage fees, mortgage placement fees, lease-up fees and transaction structuring fees (although we may be able to pass some or all of such fees on to our tenants and borrowers). In the event that any of these expenses are incurred on our behalf by our Adviser, we are required to reimburse our Adviser on a dollar-for-dollar basis for all such amounts. During the years ended December 31, 2010, 2009 and 2008, none of these expenses were incurred by our Adviser or by us directly. The actual amount of such fees that we incur in the future will depend largely upon the aggregate costs of the properties we acquire, the aggregate amount of mortgage loans we make, and the extent to which we are able to shift the burden of such fees to our tenants and borrowers. Accordingly, the amount of these fees that we will pay in the future is not determinable at this time.

*Management Services and Fees under the Advisory Agreement*

The Advisory Agreement provides for an annual base management fee equal to 2.0% of our total stockholders' equity, less the recorded value of any preferred stock, and an incentive fee based on funds from operations, or FFO. Our Adviser does not charge acquisition or disposition fees when we acquire or dispose of properties as is common in other externally managed REITs. Furthermore, there are no fees charged when our Adviser secures long or short term credit or arranges mortgage loans on our properties; however, our Adviser may earn fee income from our borrowers or tenants or other sources. This fee income earned by our Adviser, or a portion thereof, may, at the sole discretion of the Board of Directors, be credited against our base management fee as a rebate to the base management fee.

For purposes of calculating the incentive fee, FFO includes any realized capital gains and capital losses, less any distributions paid on preferred stock and senior common stock, but FFO does not include any unrealized capital gains or losses. The incentive fee would reward our Adviser if our quarterly FFO, before giving effect to any incentive fee, or pre-incentive fee FFO, exceeds 1.75%, or the hurdle rate, of total stockholders' equity, less the recorded value of any preferred stock. We pay our Adviser an incentive fee with respect to our pre-incentive fee FFO in each calendar quarter as follows:

no incentive fee in any calendar quarter in which our pre-incentive fee FFO does not exceed the hurdle rate of 1.75% (7% annualized);

100% of the amount of the pre-incentive fee FFO that exceeds the hurdle rate, but is less than 2.1875% in any calendar quarter (8.75% annualized); and

20% of the amount of our pre-incentive fee FFO that exceeds 2.1875% in any calendar quarter (8.75% annualized).

**Table of Contents**

*Quarterly Incentive Fee Based on FFO*

**Pre-incentive fee FFO**

**(expressed as a percentage of total common stockholders' equity)**

**Percentage of pre-incentive fee FFO allocated to incentive fee**

The incentive fee may be reduced because of our line of credit covenant which limits distributions to our stockholders to 95% of FFO less those acquisition-related costs that are required to be expensed under Accounting Standards Codification, or ASC, 805, Business Combinations.

*Administration Agreement*

Under the terms of the Administration Agreement, we pay separately for our allocable portion of our Administrator's overhead expenses in performing its obligations to us including, but not limited to, rent, and our allocable portion of the salaries and benefits expenses of our Administrator's employees, including, but not limited to, our chief financial officer, chief compliance officer, internal counsel, treasurer, investor relations and their respective staffs. Our allocable portion of expenses is derived by multiplying our Administrator's total expenses by the percentage of our total assets at the beginning of each quarter in comparison to the total assets of all companies managed by our Adviser under similar agreements.

*Adviser Duties and Authority under the Advisory Agreement*

Under the terms of the Advisory Agreement, our Adviser is required to use its best efforts to present to us investment opportunities consistent with our investment policies and objectives as adopted by our board of directors. In performing its duties, our Adviser, either directly or indirectly by engaging an affiliate:

finds, evaluates, and enters into contracts to purchase real estate and make mortgage loans on our behalf in compliance with our investment procedures, objectives and policies, subject to approval of our board of directors, where required;

provides advice to us and acts on our behalf with respect to the negotiation, acquisition, financing, refinancing, holding, leasing and disposition of real estate investments;

takes the actions and obtains the services necessary to effect the negotiation, acquisition, financing, refinancing, holding, leasing and disposition of real estate investments; and

provides day-to-day management of our business activities and other administrative services for us as requested by our board of directors.

Our board of directors has authorized our Adviser to make investments in any property on our behalf without the prior approval of our board if the following conditions are satisfied:

our Adviser has obtained an independent appraisal for the property indicating that the total cost of the property does not exceed its appraised value; and

our Adviser has concluded that the property, in conjunction with our other investments and proposed investments, is reasonably expected to fulfill our investment objectives and policies as established by our board of directors then in effect.

## **Table of Contents**

The actual terms and conditions of transactions involving investments in properties and mortgage loans are determined in the sole discretion of our Adviser, subject at all times to compliance with the foregoing requirements. Some types of transactions, however, require the prior approval of our board of directors, including a majority of our independent directors, including the following:

loans not secured or otherwise supported by real property;

any acquisition or mortgage loan which at the time of investment would have a cost exceeding 20% of our total assets;

transactions that involve conflicts of interest with our Adviser (other than reimbursement of expenses in accordance with the Advisory Agreement); and

the lease of assets to our Adviser, its affiliates or any of our officers or directors.

Our Adviser and Administrator also engage in other business ventures and, as a result, their resources are not dedicated exclusively to our business. For example, our Adviser and Administrator also serve as the external adviser to Gladstone Capital Corporation and Gladstone Investment Corporation, both publicly traded business development companies affiliated with us, and Gladstone Land Corporation, a private agricultural real estate company. However, under the Advisory Agreement, our Adviser is required to devote sufficient resources to the administration of our affairs to discharge its obligations under the agreement. The Advisory Agreement is not assignable or transferable by either us or our Adviser without the consent of the other party, except that our Adviser may assign the Advisory Agreement to an affiliate for whom our Adviser agrees to guarantee its obligations to us. Either we or our Adviser may assign or transfer the Advisory Agreement to a successor entity.

## ***Employees***

We do not currently have any employees and do not expect to have any employees in the foreseeable future. Currently, services necessary for our business are provided by individuals who are employees of our Adviser and our Administrator pursuant to the terms of the Advisory Agreement and the Administration Agreement, respectively. Each of our executive officers is an employee or officer, or both, of our Adviser or our Administrator. No employee of our Adviser or our Administrator will dedicate all of his or her time to us. However, we expect that 15-20 full time employees of our Adviser or our Administrator will spend substantial time on our matters during calendar year 2011. To the extent that we acquire more investments, we anticipate that the number of employees of our Adviser and our Administrator who devote time to our matters will increase.

As of December 31, 2010, our Adviser and our Administrator collectively had 51 full-time employees. A breakdown of these employees is summarized by functional area in the table below:

| <b>Number of Individuals</b> | <b>Functional Area</b>                                                      |
|------------------------------|-----------------------------------------------------------------------------|
| 10                           | Executive Management                                                        |
| 33                           | Investment Management, Portfolio Management and Due Diligence               |
| 8                            | Administration, Accounting, Compliance, Human Resources, Legal and Treasury |

## ***Competition***

We compete with a number of other real estate companies and traditional mortgage lenders, many of whom have greater marketing and financial resources than we do. Principal factors of competition in our primary

**Table of Contents**

business of investing in and owning leased industrial and commercial real property are the quality of properties, leasing terms, attractiveness and convenience of location. Additionally, our ability to compete depends upon, among other factors, trends of the national and local economies, investment alternatives, financial condition and operating results of current and prospective tenants and borrowers, availability and cost of capital, taxes and governmental regulations.

**Environmental Matters**

As a current and prior owner of real estate, we are subject to various federal, state and local environmental laws, regulations and ordinances and also could be liable to third parties resulting from environmental contamination or noncompliance at our properties. Environmental laws often impose liability without regard to whether the owner or operator knew of, or was responsible for, the presence of the contaminants, and the costs of any required investigation or cleanup of these substances can be substantial. The liability is generally not limited under such laws and could exceed the property's value and the aggregate assets of the liable party. The presence of contamination or the failure to remediate contamination at our properties also may expose us to third-party liability for personal injury or property damage, or adversely affect our ability to sell, lease or develop the real property or to borrow using the real property as collateral. These and other risks related to environmental matters are described in more detail in Item 1A. Risk Factors below.

**Available Information**

We file annual, periodic, current and other reports and information with the SEC. All filings made by us with the SEC may be copied or read at the SEC's Public Reference Room at 100 F Street NE, Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The website address is <http://www.sec.gov>.

Additionally, a copy of this Annual Report on Form 10-K, along with our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy statements and other information and any amendments to the aforementioned filings, are available on our website, [www.GladstoneCommercial.com](http://www.GladstoneCommercial.com), free of charge as soon as reasonably practicable after we electronically file such reports or amendments with, or furnish them to, the SEC. The filings can be found in the SEC filings section of our website. Our website also contains our Code of Ethics and Business Conduct and the charters of the committees of the Board of Directors. These items can be found in the Corporate Governance section of our website. Reference to our website does not constitute incorporation by reference of the information contained on the site and should not be considered part of this document. All of the aforementioned materials may also be obtained free of charge by contacting Investor Relations, Gladstone Commercial Corporation, 1521 Westbranch Drive, Suite 200, McLean, Virginia 22102, or by calling our investor relations line at (703) 287-5893.

**Table of Contents**

**Item 1A. Risk Factors**

*An investment in our securities involves a number of significant risks and other factors relating to our structure and investment objectives. As a result, we cannot assure you that we will achieve our investment objectives. You should consider carefully the following information before making an investment in our securities.*

***Risk related to the economy***

*The current state of the economy and the capital markets increases the possibility of adverse effects on our financial position, results of operations and the market price of our securities.*

The United States is recovering from the recession that it entered into during late 2007, though it continues to experience some disruptions in its financial and capital markets. As a result, conditions within the U.S. capital markets generally, and the U.S. real estate capital markets particularly, continue to experience dislocation and stress. We believe that it will be a few more years before the United States fully recovers from the recession. As a result, the continued challenging economic conditions could still materially and adversely impact the financial condition of one or more of our tenants and, therefore, could increase the likelihood that a tenant may declare bankruptcy or default upon its payment obligations arising under a related lease.

The recession generally, and the disruptions in the capital markets in particular, have decreased liquidity and increased our cost of equity capital which impacted our ability to raise capital during 2010 and in turn reduced our ability to make new investments. As a result we only acquired one property during 2010, however, we were able to raise equity capital in February 2011, and believe that our liquidity position is improving. The longer these conditions persist, the greater the probability that these factors will have an adverse effect on our liquidity, financial condition, results of operations, ability to pay distributions to stockholders and the market price of our securities.

***Risks related to our financing***

*Our line of credit contains various covenants which, if not complied with, could accelerate our repayment obligations, thereby materially and adversely affecting our liquidity, financial condition, results of operations and ability to pay distributions to stockholders.*

The agreement governing our line of credit requires us to comply with certain financial and operational covenants. These covenants require us to, among other things, maintain certain financial ratios, including fixed charge coverage, debt service coverage and a minimum net worth. We are also required to limit our distributions to stockholders to 95% of our FFO, and continued compliance with this covenant may require us to limit our distributions to stockholders. As of December 31, 2010, we were in compliance with these covenants. However, our continued compliance with these covenants depends on many factors, and could be impacted by current or future economic conditions, and thus there are no assurances that we will continue to comply with these covenants. In addition, we have \$48.0 million of mortgage debt maturing in October 2013. Under the terms of the line of credit, we must refinance, extend or have enough cash on hand, including availability under our line of credit, as of April 2013 or we would be considered in default. Failure to comply with these covenants would result in a default which, if we were unable to obtain a waiver from the lenders, could accelerate our repayment obligations under the line of credit and thereby have a material adverse impact on our liquidity, financial condition, results of operations and ability to pay distributions to stockholders.

*Our business strategy relies heavily on external financing, which may expose us to risks associated with leverage such as restrictions on additional borrowing and payment of distributions to stockholders, risks associated with balloon payments, and risk of loss of our equity upon foreclosure.*

## **Table of Contents**

Our current business strategy involves the use of leverage so that we may make more investments than would otherwise be possible in order to maximize potential returns to stockholders. If the income generated by our properties and other assets fails to cover our debt service, we could be forced to reduce or eliminate distributions to our stockholders and may experience losses.

Our ability to achieve our investment objectives will be affected by our ability to borrow money in sufficient amounts and on favorable terms. We expect that we will borrow money that will be secured by our properties and that these financing arrangements will contain customary covenants such as those that limit our ability, without the prior consent of the lender, to further mortgage the applicable property or to discontinue insurance coverage. Accordingly, we may be unable to obtain the degree of leverage we believe to be optimal, which may cause us to have less cash for distribution to stockholders than we would have with an optimal amount of leverage. Our use of leverage could also make us more vulnerable to a downturn in our business or the economy, as it may become difficult to meet our debt service obligations if our cash flows are reduced due to tenant defaults. There is also a risk that a significant increase in the ratio of our indebtedness to the measures of asset value used by financial analysts may have an adverse effect on the market price of our securities.

Some of our debt financing arrangements may require us to make lump-sum or balloon payments at maturity. Our ability to make a balloon payment at maturity is uncertain and may depend upon our ability to obtain additional financing or to sell the financed property. At the time the balloon payment is due, we may not be able to refinance the balloon payment on terms as favorable as the original loan or sell the property at a price sufficient to make the balloon payment, which could adversely affect the amount of distributions to our stockholders.

We intend to acquire additional properties by using our line of credit and by continuing to seek long-term financing, where we will borrow all or a portion of the purchase price of a potential acquisition and securing the loan with a mortgage on some or all of our existing real property. However, the market for long-term mortgages has been limited, as the collateralized mortgage-backed securities, or CMBS, market has experienced significant disruption. We are, however, beginning to see banks that are willing to issue medium-term mortgages, between two and five years, on substantially less favorable terms than were previously available. Consequently, we continue to focus on using medium-term mortgages to finance our real estate activities until the market for long-term mortgages returns. To date we have obtained approximately \$260 million in long-term financing, which we have used to acquire additional properties. If we are unable to make our debt payments as required, a lender could foreclose on the property securing its loan. This could cause us to lose part or all of our investment in such property which in turn could cause the value of our securities or the amount of distributions to our stockholders to be reduced.

*A change in the value of our assets could cause us to experience a cash shortfall, be in default of our loan covenants, lose management control or incur a charge for the impairment of assets.*

We borrow on a secured basis under the New Line of Credit. A significant reduction in value of the assets secured as collateral could require us to post additional assets or pay down the balance of the New Line of Credit. Although we believe that we have significant excess collateral and capacity, future asset values are uncertain. If we were unable to meet a request to add collateral to the New Line of Credit, this inability would have a material adverse affect on our liquidity and our ability to meet our loan covenants. We may determine that the value of an individual asset, or group of assets, was irrevocably impaired, and that we may need to record a charge to write-down the value of the asset to reflect its current estimated value based upon its intended use.

*Interest rate changes may adversely affect our results of operations.*

We may experience interest rate volatility in connection with mortgage loans on our properties or other variable-rate debt that we may obtain from time to time. Certain of our leases contain escalations based on market interest rates and the interest rate on our existing line of credit is variable. Although we seek to mitigate this risk by structuring such provisions to contain a minimum interest rate or escalation rate, as

## **Table of Contents**

applicable, these features do not eliminate this risk. We are also exposed to the effects of interest rate changes as a result of the holding of our cash and cash equivalents in short-term, interest-bearing investments. We have not entered into any derivative contracts to attempt to further manage our exposure to interest rate fluctuations. A significant change in interest rates could have an adverse impact on our results of operations.

### ***Risks related to the real estate industry***

*We are subject to certain risks associated with real estate ownership and lending which could reduce the value of our investments.*

Our investments include net leased industrial and commercial property and mortgage loans secured by industrial and commercial real estate. Our performance, and the value of our investments, is subject to risks inherent to the ownership and operation of these types of properties, including:

changes in the general economic climate;

changes in local conditions such as an oversupply of space or reduction in demand for real estate;

changes in interest rates and the availability of financing;

competition from other available space; and

changes in laws and governmental regulations, including those governing real estate usage, zoning and taxes.

The debt obligations of our tenants and borrowers are dependent upon certain factors which neither we nor our tenants or borrowers control, such as national, local and regional business and economic conditions, government economic policies, and the level of interest rates. As discussed in *Risk related to the economy* above, the credit markets have tightened resulting in a significant contraction in available liquidity. Accordingly, the credit market constraints and recession may increase the operating expenses of our tenants and borrowers and decrease their ability to make lease or mortgage payments, and thereby adversely affect our liquidity, financial condition, results of operations and ability to pay distributions to our stockholders.

*Competition for the acquisition of real estate may impede our ability to make acquisitions or increase the cost of these acquisitions.*

We compete for the acquisition of properties with many other entities engaged in real estate investment activities, including financial institutions, institutional pension funds, other REITs, other public and private real estate companies and private real estate investors. These competitors may prevent us from acquiring desirable properties or may cause an increase in the price we must pay for real estate. Our competitors may have greater resources than we do, and may be willing to pay more for certain assets or may have a more compatible operating philosophy with our acquisition targets. In particular, larger REITs may enjoy significant competitive advantages that result from, among other things, a lower cost of capital and enhanced operating efficiencies. Our competitors may also adopt transaction structures similar to ours, which would decrease our competitive advantage in offering flexible transaction terms. In addition, the number of entities and the amount of funds competing for suitable investment properties may increase, resulting in increased demand and increased prices paid for these properties.

*Our ownership of properties through ground leases exposes us to risks which are different than those resulting from our ownership of fee title to other properties.*

We have acquired an interest in certain of our properties by acquiring a leasehold interest in the land underlying the property, and we may acquire additional properties in the future that are subject to similar ground leases. In this situation, we have no economic interest in the land underlying the property and do not control this land. Because we do not control the underlying land, this type of ownership interest poses potential risks for our business because (i) if the ground lease terminates for any reason, we will lose our

## **Table of Contents**

interest in the property, including any investment that we made in the property, (ii) if our tenant defaults under the previously existing lease, we will continue to be obligated to meet the terms and conditions of the ground lease without the annual amount of ground lease payments reimbursable to us by the tenant, and (iii) if the third party owning the land under the ground lease disrupts our use either permanently or for a significant period of time, then the value of our assets could be impaired and our results of operations could be adversely affected.

### ***Risks related to our tenants, borrowers and properties***

*Highly leveraged tenants and borrowers may be unable to pay rent or make mortgage payments, which could adversely affect our cash available to make distributions to our stockholders.*

Some of our tenants and borrowers may have recently been either restructured using leverage, or acquired in a leveraged transaction. Tenants and borrowers that are subject to significant debt obligations may be unable to make their rent or mortgage payments if there are adverse changes to their businesses or because of the impact of the recession discussed in *Risk related to the economy*. Tenants that have experienced leveraged restructurings or acquisitions will generally have substantially greater debt and substantially lower net worth than they had prior to the leveraged transaction. In addition, the payment of rent and debt service may reduce the working capital available to leveraged entities and prevent them from devoting the resources necessary to remain competitive in their industries. In situations where management of the tenant or borrower will change after a transaction, it may be difficult for our Adviser to determine with certainty the likelihood of the tenant's or borrower's business success and of its ability to pay rent or make mortgage payments throughout the lease or loan term. These companies generally are more vulnerable to adverse economic and business conditions, and increases in interest rates.

Leveraged tenants and borrowers are more susceptible to bankruptcy than unleveraged tenants. Bankruptcy of a tenant or borrower could cause:

- the loss of lease or mortgage payments to us;

- an increase in the costs we incur to carry the property occupied by such tenant;

- a reduction in the value of our securities; or

- a decrease in distributions to our stockholders.

Under bankruptcy law, a tenant who is the subject of bankruptcy proceedings has the option of continuing or terminating any unexpired lease. If a bankrupt tenant terminates a lease with us, any claim we might have for breach of the lease (excluding a claim against collateral securing the claim) will be treated as a general unsecured claim. Our claim would likely be capped at the amount the tenant owed us for unpaid rent prior to the bankruptcy unrelated to the termination, plus the greater of one year's lease payments or 15% of the remaining lease payments payable under the lease (but no more than three years' lease payments). In addition, due to the long-term nature of our leases and terms providing for the repurchase of a property by the tenant, a bankruptcy court could re-characterize a net lease transaction as a secured lending transaction. If that were to occur, we would not be treated as the owner of the property, but might have additional rights as a secured creditor.

*Net leases may not result in fair market lease rates over time.*

We expect a large portion of our rental income to come from net leases and net leases frequently provide the tenant greater discretion in using the leased property than ordinary property leases, such as the right to sublease the property, subject to our approval, to make alterations in the leased premises and to terminate the lease prior to its expiration under specified circumstances. Further, net leases are typically for longer lease terms and, thus, there is an increased risk that contractual rental increases in future years will fail to result in fair market rental rates during those years. As a result, our income and distributions to our stockholders could be lower than they would otherwise be if we did not engage in net leases.

**Table of Contents**

*Many of our tenants are small and medium size businesses, which exposes us to additional risks unique to these entities.*

Leasing real property or making mortgage loans to small and medium-sized businesses exposes us to a number of unique risks related to these entities, including the following:

*Small and medium-sized businesses may have limited financial resources and may not be able to make their lease or mortgage payments on a timely basis, or at all.* A small or medium-sized tenant or borrower is more likely to have difficulty making its lease or mortgage payments when it experiences adverse events, such as the failure to meet its business plan, a downturn in its industry or negative economic conditions. In addition, because of the lack of available credit in the current marketplace, as discussed further in *Risk related to the economy* above, our tenants might not be able to obtain the financing necessary to fund their working capital, which could hinder their ability to make their lease or mortgage payment on a timely basis, or at all.

*Small and medium-sized businesses typically have narrower product lines and smaller market shares than large businesses.* Because our target tenants and borrowers are smaller businesses, they will tend to be more vulnerable to competitors' actions and market conditions, as well as general economic downturns. In addition, our target tenants and borrowers may face intense competition, including competition from companies with greater financial resources, more extensive development, manufacturing, marketing and other capabilities and a larger number of qualified managerial and technical personnel.

*There is generally little or no publicly available information about our target tenants and borrowers.* Many of our tenants and borrowers are likely to be privately owned businesses, about which there is generally little or no publicly available operating and financial information. As a result, we will rely on our Adviser to perform due diligence investigations of these tenants and borrowers, their operations and their prospects. We may not learn all of the material information we need to know regarding these businesses through our investigations.

*Small and medium-sized businesses generally have less predictable operating results.* We expect that many of our tenants and borrowers may experience significant fluctuations in their operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, may require substantial additional capital to support their operations, to finance expansion or to maintain their competitive positions, may otherwise have a weak financial position or may be adversely affected by changes in the business cycle. Our tenants and borrowers may not meet net income, cash flow and other coverage tests typically imposed by their senior lenders. The failure of a tenant or borrower to satisfy financial or operating covenants imposed by senior lenders could lead to defaults and, potentially, foreclosure on credit facilities, which could additionally trigger cross-defaults in other agreements. If this were to occur, it is possible that the ability of the tenant or borrower to make required payments to us would be jeopardized.

*Small and medium-sized businesses are more likely to be dependent on one or two persons.* Typically, the success of a small or medium-sized business also depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of one or more of these persons could have a material adverse impact on our tenant or borrower and, in turn, on us.

*Small and medium-sized businesses may have limited operating histories.* While we intend to target as tenants and borrowers stable companies with proven track records, we may lease properties or lend money to new companies that meet our other investment criteria. Tenants or borrowers with limited operating histories will be exposed to all of the operating risks that new businesses face and may be particularly susceptible to, among other risks, market downturns, competitive pressures and the departure of key executive officers.

*We may not have funding for future tenant improvements.*

## **Table of Contents**

When a tenant at one of our properties does not renew its lease or otherwise vacates its space in one of our buildings, it is likely that, in order to attract one or more new tenants, we will be required to expend substantial funds for tenant improvements and tenant refurbishments to the vacated space. We cannot assure you that we will have sufficient sources of funding available to us for such purposes in the future.

*Illiquidity of real estate investments may make it difficult for us to sell properties in response to market conditions and could harm our financial condition and ability to make distributions.*

To the extent the properties are not subject to triple-net leases, some significant expenditures such as real estate taxes and maintenance costs are generally not reduced when circumstances cause a reduction in income from the investment. Should these events occur, our income and funds available for distribution could be adversely affected. In addition, as a REIT, we may be subject to a 100% tax on net income derived from the sale of property considered to be held primarily for sale to customers in the ordinary course of our business. We may seek to avoid this tax by complying with certain safe harbor rules that generally limit the number of properties we may sell in a given year, the aggregate expenditures made on such properties prior to their disposition, and how long we retain such properties before disposing of them. However, we can provide no assurance that we will always be able to comply with these safe harbors. If compliance is possible, the safe harbor rules may restrict our ability to sell assets in the future and achieve liquidity that may be necessary to fund distributions.

*Our real estate investments may include special use and single or multi-tenant properties that may be difficult to sell or re-lease upon tenant defaults or early lease terminations.*

We focus our investments on commercial and industrial properties, a number of which include manufacturing facilities, special use storage or warehouse facilities and special use single or multi-tenant properties. These types of properties are relatively illiquid compared to other types of real estate and financial assets. This illiquidity will limit our ability to quickly change our portfolio in response to changes in economic or other conditions. With these properties, if the current lease is terminated or not renewed or, in the case of a mortgage loan, if we take such property in foreclosure, we may be required to renovate the property or to make rent concessions in order to lease the property to another tenant or sell the property. In addition, in the event we are forced to sell the property, we may have difficulty selling it to a party other than the tenant or borrower due to the special purpose for which the property may have been designed.

These and other limitations may affect our ability to sell or re-lease properties without adversely affecting returns to our stockholders.

*Our real estate investments have a limited number of tenants and are concentrated in a limited number of industries, which subjects us to an increased risk of significant loss if any one of these tenants is unable to pay or if particular industries experience downturns.*

As of December 31, 2010, we owned 65 properties and had 50 tenants in these properties, and our 5 largest tenants accounted for approximately 24.2% of our total rental income. A consequence of a limited number of tenants is that the aggregate returns we realize may be substantially adversely affected by the unfavorable performance of a small number of tenants. We do not have fixed guidelines for industry concentration and our investments could potentially be concentrated in relatively few industries. As of December 31, 2010, 15.0% of our total rental income was earned from tenants in the electronic industry, 14.9% of our total rental income was earned from tenants in the healthcare, education and childcare industries, and 13.3% of our total rental income was earned from tenants in the telecommunications industry. As a result, a downturn in an industry in which we have invested a significant portion of our total assets could have a material adverse effect on us.

*The inability of a tenant in a single tenant property to pay rent will reduce our revenues and increase our carrying costs of the building.*

Since most of our properties are occupied by a single tenant, the success of our investments will be materially dependent on the financial stability of these tenants. If a tenant defaults, our rental revenues would be reduced and our expenses associated with carrying the property would increase, as we will be

**Table of Contents**

responsible for payments such as taxes and insurance. Lease payment defaults by these tenants could adversely affect our cash flows and cause us to reduce the amount of distributions to stockholders. In the event of a default by a tenant, we may experience delays in enforcing our rights as landlord and may incur substantial costs in protecting our investment and re-leasing our property. If a lease is terminated, there is no assurance that we will be able to lease the property for the rent previously received or sell the property without incurring a loss.

*We may be unable to renew leases, lease vacant space or re-lease space as leases expire, which could adversely affect our business and our ability to make distributions to our stockholders.*

If we cannot renew leases, we may be unable to re-lease our properties at rates equal to or above the current rate. Even if we can renew leases, tenants may be able to negotiate lower rates as a result of market conditions. Market conditions may also hinder our ability to lease vacant space in newly developed or redeveloped properties. In addition, we may enter into or acquire leases for properties that are specially suited to the needs of a particular tenant. Such properties may require renovations, tenant improvements or other concessions in order to lease them to other tenants if the initial leases terminate. Any of these factors could adversely impact our financial condition, results of operations, cash flow, our ability to pay distributions to our stockholders.

*Liability for uninsured losses could adversely affect our financial condition.*

Losses from disaster-type occurrences (such as wars or earthquakes) may be either uninsurable or not insurable on economically viable terms. Should an uninsured loss occur, we could lose our capital investment or anticipated profits and cash flow from one or more properties.

*We could incur significant costs related to government regulation and private litigation over environmental matters.*

Under various environmental laws, including the Comprehensive Environmental Response, Compensation and Liability Act, or CERCLA, a current or previous owner or operator of real property may be liable for contamination resulting from the release or threatened release of hazardous or toxic substances or petroleum at that property, and an entity that arranges for the disposal or treatment of a hazardous or toxic substance or petroleum at another property may be held jointly and severally liable for the cost to investigate and clean up such property or other affected property. Such parties are known as potentially responsible parties, or PRPs. Environmental laws often impose liability without regard to whether the owner or operator knew of, or was responsible for, the presence of the contaminants, and the costs of any required investigation or cleanup of these substances can be substantial. PRPs are liable to the government as well as to other PRPs who may have claims for contribution. The liability is generally not limited under such laws and could exceed the property's value and the aggregate assets of the liable party. The presence of contamination or the failure to remediate contamination at our properties also may expose us to third-party liability for personal injury or property damage, or adversely affect our ability to sell, lease or develop the real property or to borrow using the real property as collateral.

Environmental laws also impose ongoing compliance requirements on owners and operators of real property.

Environmental laws potentially affecting us address a wide variety of matters, including, but not limited to, asbestos-containing building materials, storage tanks, storm water and wastewater discharges, lead-based paint, wetlands and hazardous wastes. Failure to comply with these laws could result in fines and penalties and/or expose us to third-party liability. Some of our properties may have conditions that are subject to these requirements, and we could be liable for such fines or penalties and/or liable to third parties for those conditions.

*We could be exposed to liability and remedial costs related to environmental matters.*

Certain of our properties may contain, or may have contained, asbestos-containing building materials, or ACBMs.

Environmental laws require that ACBMs be properly managed and maintained and may impose fines and penalties on building owners and operators for failure to comply with these requirements. Also,

## Table of Contents

certain of our properties may contain, or may have contained, or are adjacent to or near other properties that have contained or currently contain storage tanks for the storage of petroleum products or other hazardous or toxic substances. These operations create a potential for the release of petroleum products or other hazardous or toxic substances. Certain of our properties may contain, or may have contained, elevated radon levels. Third parties may be permitted by law to seek recovery from owners or operators for property damage and/or personal injury associated with exposure to contaminants, including, but not limited to, petroleum products, hazardous or toxic substances and asbestos fibers. Also, certain of our properties may contain regulated wetlands that can delay or impede development or require costs to be incurred to mitigate the impact of any disturbance. Absent appropriate permits, we can be held responsible for restoring wetlands and be required to pay fines and penalties.

Certain of our properties may contain, or may have contained, microbial matter such as mold and mildew. The presence of microbial matter could adversely affect our results of operations. In addition, if any of our property is not properly connected to a water or sewer system, or if the integrity of such systems are breached, or if water intrusion into our buildings otherwise occurs, microbial matter or other contamination can develop. When excessive moisture accumulates in buildings or on building materials, mold growth may occur, particularly if the moisture problem remains undiscovered or is not addressed over a period of time. Some molds may produce airborne toxins or irritants. If this were to occur, we could incur significant remedial costs and we may also be subject to material private damage claims and awards. Concern about indoor exposure to mold has been increasing, as exposure to mold may cause a variety of adverse health effects and symptoms, including allergic or other reactions. If we become subject to claims in this regard, it could materially and adversely affect us and our future insurability for such matters.

Independent environmental consultants conduct Phase I environmental site assessments on all of our acquisitions. Phase I environmental site assessments are intended to evaluate information regarding the environmental condition of the surveyed property and surrounding properties based generally on visual observations, interviews and certain publicly available databases. These assessments do not typically take into account all environmental issues including, but not limited to, testing of soil or groundwater or the possible presence of asbestos, lead-based paint, radon, wetlands or mold. The results of these assessments are addressed and could result in either a cancellation of the purchase, the requirement of the seller to remediate issues, or additional costs on our part to remediate the issue. None of the previous site assessments revealed any past or present environmental liability that we believe would be material to us. However, the assessments may have failed to reveal all environmental conditions, liabilities or compliance concerns. Material environmental conditions, liabilities or compliance concerns may have arisen after the assessments were conducted or may arise in the future, and future laws, ordinances or regulations may impose material additional environmental liability. We cannot assure you that costs of future environmental compliance will not affect our ability to make distributions or that such costs or other remedial measures will not be material to us.

*If a sale-leaseback transaction is re-characterized in a tenant's bankruptcy proceeding, our financial condition could be adversely affected.*

We may enter into sale-leaseback transactions, whereby we would purchase a property and then lease the same property back to the person from whom we purchased it. In the event of the bankruptcy of a tenant, a transaction structured as a sale-leaseback may be re-characterized as either a financing or a joint venture, either of which outcomes could adversely affect our business. If the sale-leaseback were re-characterized as a financing, we might not be considered the owner of the property, and as a result would have the status of a creditor in relation to the tenant. In that event, we would no longer have the right to sell or encumber our ownership interest in the property. Instead, we would have a claim against the tenant for the amounts owed under the lease, with the claim arguably secured by the property. The tenant/debtor might have the ability to propose a plan restructuring the term, interest rate and amortization schedule of its outstanding balance. If confirmed by the bankruptcy court, we could be bound by the new terms, and prevented from foreclosing our lien on the property. If the sale-leaseback were re-characterized as a joint venture, we could be treated as a co-venturer with our lessee with regard to the property. As a result, we could be held liable, under

## **Table of Contents**

some circumstances, for debts incurred by the lessee relating to the property. Either of these outcomes could adversely affect our cash flow and our ability to pay distributions to stockholders.

### ***Risks related to our Adviser***

*We are dependent upon our key management personnel, who are employed by our Adviser, for our future success, particularly David Gladstone, Terry Lee Brubaker and George Stelljes III.*

We are dependent on our senior management and other key management members to carry out our business and investment strategies. Our future success depends to a significant extent on the continued service and coordination of our senior management team, particularly David Gladstone, our chairman and chief executive officer, Terry Lee Brubaker, our vice chairman and chief operating officer, and George Stelljes III, our president and chief investment officer, all of whom are subject to an employment agreement with our Adviser. The departure of any of our executive officers or key employees could have a material adverse effect on our ability to implement our business strategy and to achieve our investment objectives.

*Our success depends on the performance of our Adviser and if our Adviser makes inadvisable investment or management decisions, our operations could be materially adversely impacted.*

Our ability to achieve our investment objectives and to pay distributions to our stockholders is dependent upon the performance of our Adviser in evaluating potential investments, selecting and negotiating property purchases and dispositions and mortgage loans, selecting tenants and borrowers, setting lease or mortgage loan terms and determining financing arrangements. Accomplishing these objectives on a cost-effective basis is largely a function of our Adviser's marketing capabilities, management of the investment process, ability to provide competent, attentive and efficient services and our access to financing sources on acceptable terms. Our stockholders have no opportunity to evaluate the terms of transactions or other economic or financial data concerning our investments and must rely entirely on the analytical and management abilities of our Adviser and the oversight of our board of directors. If our Adviser or our board of directors makes inadvisable investment or management decisions, our operations could be materially adversely impacted. As we grow, our Adviser may be required to hire, train, supervise and manage new employees. Our Adviser's failure to effectively manage our future growth could have a material adverse effect on our business, financial condition and results of operations.

*We may have conflicts of interest with our Adviser and other affiliates.*

Our Adviser manages our business and locates, evaluates, recommends and negotiates the acquisition of our real estate investments. At the same time, our advisory agreement permits our Adviser to conduct other commercial activities and provide management and advisory services to other entities, including, but not limited to, Gladstone Capital Corporation, Gladstone Investment Corporation and Gladstone Land Corporation, an entity affiliated with our chairman David Gladstone. Moreover, with the exception of our chief financial officer, all of our officers and directors are also officers and directors of Gladstone Capital Corporation and Gladstone Investment Corporation, which actively make loans to and invest in small and medium-sized companies. As a result, we may from time to time have conflicts of interest with our Adviser in its management of our business and with Gladstone Capital and Gladstone Investment, which may arise primarily from the involvement of our Adviser, Gladstone Capital, Gladstone Investment, Gladstone Land and their affiliates in other activities that may conflict with our business.

Examples of these potential conflicts include:

- our Adviser may realize substantial compensation on account of its activities on our behalf, and may, therefore, be motivated to approve acquisitions solely on the basis of increasing compensation to itself;

- we may experience competition with our affiliates for financing transactions;

- our Adviser may earn fee income from our borrowers or tenants; and

**Table of Contents**

our Adviser and other affiliates such as Gladstone Capital, Gladstone Investment and Gladstone Land could compete for the time and services of our officers and directors.

These and other conflicts of interest between us and our Adviser and other affiliates could have a material adverse effect on the operation of our business and the selection or management of our real estate investments.

*Our Adviser is not obligated to provide a waiver of the incentive fee, which could negatively impact our earnings and our ability to maintain our current level of, or increase, distributions to our stockholders.*

The Advisory Agreement contemplates a quarterly incentive fee based on our funds from operations. Our Adviser has the ability to issue a full or partial waiver of the incentive fee for current and future periods; however, our Adviser is not required to issue any waiver. Any waiver issued by our Adviser is an unconditional and irrevocable waiver. For the years ended December 31, 2010, 2009 and 2008, an unconditional and irrevocable voluntary waiver was issued by our Adviser for approximately \$0.2 million, \$0.7 million and \$2.2 million, respectively. If our Adviser does not issue this waiver in future quarters, it could negatively impact our earnings and may compromise our ability to maintain our current level of, or increase, distributions to our stockholders, which could have a material adverse impact on the market price of our securities.

*We may be obligated to pay our Adviser incentive compensation even if we incur a loss.*

The Advisory Agreement entitles our Adviser to incentive compensation based on our FFO, which rewards the Adviser if our quarterly FFO (before giving effect to any incentive fee) exceeds 1.75% (7% annualized) of our total stockholders' equity (less the recorded value of any preferred stock). Our pre-incentive fee FFO for incentive compensation purposes excludes the effect of any unrealized gains, losses or other items that do not affect realized net income that we may incur in the fiscal quarter, even if such losses result in a net loss on our statement of operations for that quarter. Thus, we may be required to pay our Adviser incentive compensation for a fiscal quarter even if we incur a net loss for that quarter.

**Risks Related to Qualification and Operation as a REIT**

*If we fail to qualify as a REIT, our operations and dividends to stockholders would be adversely impacted.*

We intend to continue to be organized and to operate so as to qualify as a REIT under the Internal Revenue Code of 1986, as amended (the "Code"). A REIT generally is not taxed at the corporate level on income it currently distributes to its stockholders. Qualification as a REIT involves the application of highly technical and complex rules for which there are only limited judicial or administrative interpretations. The determination of various factual matters and circumstances not entirely within our control may affect our ability to continue to qualify as a REIT. In addition, new legislation, new regulations, administrative interpretations or court decisions could significantly change the tax laws, possibly with retroactive effect, with respect to qualification as a REIT or the federal income tax consequences of such qualification.

If we were to fail to qualify as a REIT in any taxable year:

we would not be allowed to deduct our distributions to stockholders when computing our taxable income;

we would be subject to federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates;

we would be disqualified from being taxed as a REIT for the four taxable years following the year during which qualification was lost unless entitled to relief under certain statutory provisions;

our cash available for dividends to stockholders would be reduced; and

**Table of Contents**

we may be required to borrow additional funds or sell some of our assets in order to pay corporate tax obligations that we may incur as a result of our disqualification.

*We may need to incur additional borrowings to meet the REIT minimum distribution requirement and to avoid excise tax.*

In order to maintain our qualification as a REIT, we are required to distribute to our stockholders at least 90% of our annual real estate investment trust taxable income (excluding any net capital gain and before application of the dividends paid deduction). To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to U.S. federal corporate income tax on our undistributed taxable income. In addition, we are subject to a 4% nondeductible excise tax on the amount, if any, by which certain distributions paid by us with respect to any calendar year are less than the sum of (i) 85% of our ordinary income for that year, (ii) 95% of our net capital gain for that year and (iii) 100% of our undistributed taxable income from prior years. Although we intend to pay dividends to our stockholders in a manner that allows us to meet the 90% distribution requirement and avoid this 4% excise tax, we cannot assure you that we will always be able to do so.

*Complying with REIT requirements may cause us to forgo otherwise attractive opportunities or liquidate otherwise attractive investments.*

To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the nature and diversification of our assets, the sources of our gross income, the amounts we distribute to our stockholders and the ownership of our capital stock. In order to meet these tests, we may be required to forgo investments we might otherwise make. Thus, compliance with the REIT requirements may hinder our performance. In particular, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified real estate assets. The remainder of our investment in securities (other than government securities, securities of taxable REIT subsidiaries (each, a TRS ) and qualified real estate assets) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities, securities of TRSs and qualified real estate assets) can consist of the securities of any one issuer, and no more than 25% of the value of our total assets can be represented by the securities of one or more TRSs.

We also must ensure that (i) at least 75% of our gross income for each taxable year consists of certain types of income that we derive, directly or indirectly, from investments relating to real property or mortgages on real property or qualified temporary investment income and (ii) at least 95% of our gross income for each taxable year consists of income that is qualifying income for purposes of the 75% gross income test, other types of interest and dividends, gain from the sale or disposition of stock or securities, or any combination of these.

In addition, we may be required to make distributions to our stockholders at disadvantageous times or when we do not have funds readily available for distribution. If we fail to comply with these requirements at the end of any calendar quarter, we must qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate otherwise attractive investments, and may be unable to pursue investments that would otherwise be advantageous to us in order to satisfy the asset and gross income requirements for qualifying as a REIT. These actions could have the effect of reducing our income and the amounts available for distribution to our stockholders. Thus, compliance with the REIT requirements may hinder our ability to make, and, in certain cases, maintain ownership of certain attractive investments.

*We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our securities.*

## **Table of Contents**

At any time, the federal income tax laws governing REITs or the administrative interpretations of those laws may be amended. We cannot predict when or if any new federal income tax law, regulation, or administrative interpretation, or any amendment to any existing federal income tax law, regulation or administrative interpretation, will be adopted, promulgated or become effective and any such law, regulation, or interpretation may take effect retroactively. We and our stockholders could be adversely affected by any such change in, or any new, federal income tax law, regulation or administrative interpretation.

*Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.*

The maximum tax rate applicable to income from qualified dividends payable to U.S. stockholders that are individuals, trusts and estates has been reduced by legislation to 15% (currently through the end of 2012). Dividends payable by REITs, however, generally are not eligible for the reduced rates. Although this legislation does not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including our stock.

*Complying with REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.*

The REIT provisions of the Code substantially limit our ability to hedge our liabilities. Any income from a hedging transaction that we enter into to manage risk of interest rate changes, price changes or currency fluctuations with respect to borrowings made or to be made to acquire or carry real estate assets does not constitute gross income for purposes of the gross income requirements. To the extent that we enter into other types of hedging transactions, the income from those transactions is likely to be treated as non-qualifying income for purposes of both of the gross income tests. As a result of these rules, we may need to limit our use of advantageous hedging techniques or implement those hedges through TRSs. This could increase the cost of our hedging activities because any TRS that we may form would be subject to tax on gains or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear. In addition, losses incurred by a TRS generally will not provide any tax benefit, except for being carried forward against future taxable income earned by the TRS.

*To the extent that our distributions represent a return of capital for tax purposes, you could recognize an increased capital gain upon a subsequent sale of your stock.*

Distributions in excess of our current and accumulated earnings and profits and not treated by us as a dividend will not be taxable to a U.S. stockholder to the extent such distributions do not exceed the stockholder's adjusted tax basis in its shares of our stock but instead will constitute a return of capital and will reduce the stockholder's adjusted tax basis in its shares of our stock. If distributions by us result in a reduction of a stockholder's adjusted basis in its shares of our stock, subsequent sales by such stockholder of its shares of our stock potentially will result in recognition of an increased capital gain or reduced capital loss due to the reduction in such stockholder's adjusted basis in its shares of our stock.

### ***Other risks***

*If we invest in mortgage loans, such investments may be affected by unfavorable real estate market conditions, including interest rate fluctuations, which could decrease the value of those loans and our results of operations.*

If we invest in mortgage loans, we will be at risk of defaults by the borrowers on those mortgage loans as well as interest rate risks. To the extent we incur delays in liquidating such defaulted mortgage loans, we may not be able to obtain sufficient proceeds to repay all amounts due to us under the mortgage loans.

**Table of Contents**

Further, we will not know whether the values of the properties securing the mortgage loans will remain at the levels existing on the dates of origination of those mortgage loans. If the values of the underlying properties fall, our risk will increase because of the lower value of the security associated with such loans.

*Recent accounting pronouncements may impact our results of operations.*

Beginning January 1, 2009, Accounting Standards Codification, or ASC, 805, Business Combinations, significantly changed the accounting for acquisitions involving business combinations, including our acquisition of properties with existing leases in place, as it requires that the assets and liabilities of all business combinations be recorded at fair value, with limited exceptions. ASC 805 requires that all expenses related to an acquisition be expensed as incurred, rather than capitalized into the cost of the acquisition as had been required by the previous accounting. ASC 805 was effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008. We anticipate that approximately 1% of the total acquisition price will be expensed as part of the acquisition; however, this amount could differ significantly. Because we only acquired one property during 2010, this pronouncement did not have a significant impact on our operations during 2010. We expect, however, that the expensing of acquisition costs will lower our earnings during 2011 and any future years in which we acquire significant amounts of new properties.

*We are subject to restrictions that may discourage a change of control. Certain provisions contained in our articles of incorporation and Maryland law may prohibit or restrict a change of control.*

Our articles of incorporation prohibit ownership of more than 9.8% of the outstanding shares of our capital stock by one person. This restriction may discourage a change of control and may deter individuals or entities from making tender offers for our capital stock, which offers might otherwise be financially attractive to our stockholders or which might cause a change in our management.

Our board of directors is divided into three classes, with the term of the directors in each class expiring every third year. At each annual meeting of stockholders, the successors to the class of directors whose term expires at such meeting will be elected to hold office for a term expiring at the annual meeting of stockholders held in the third year following the year of their election. After election, a director may only be removed by our stockholders for cause. Election of directors for staggered terms with limited rights to remove directors makes it more difficult for a hostile bidder to acquire control of us. The existence of this provision may negatively impact the price of our securities and may discourage third-party bids to acquire our securities. This provision may reduce any premiums paid to stockholders in a change in control transaction.

Certain provisions of Maryland law applicable to us prohibit business combinations with:

any person who beneficially owns 10% or more of the voting power of our common stock, referred to as an interested stockholder;

an affiliate of ours who, at any time within the two-year period prior to the date in question, was an interested stockholder; or

an affiliate of an interested stockholder.

These prohibitions last for five years after the most recent date on which the interested stockholder became an interested stockholder. Thereafter, any business combination with the interested stockholder must be recommended by our board of directors and approved by the affirmative vote of at least 80% of the votes entitled to be cast by holders of our outstanding shares of common stock and two-thirds of the votes entitled to be cast by holders of our common stock other than shares held by the interested stockholder. These requirements could have the effect of inhibiting a change in control even if a change in control were in our stockholders' interest. These provisions of Maryland law do not apply, however, to business combinations that are approved or exempted by our board of directors prior to the time that someone becomes an interested stockholder.

**Table of Contents**

*Market conditions could adversely affect the market price and trading volume of our securities.*

The market price of our common and preferred stock may be highly volatile and subject to wide fluctuations, and the trading volume in our common and preferred stock may fluctuate and cause significant price variations to occur. Due to market volatility, our common stock significantly fluctuated during 2010. We cannot assure investors that the market price of our common and preferred stock will not fluctuate or decline further in the future. Some market conditions that could negatively affect our share price or result in fluctuations in the price or trading volume of our securities include:

price and volume fluctuations in the stock market from time to time, which are often unrelated to the operating performance of particular companies;

significant volatility in the market price and trading volume of shares of REITs, real estate companies or other companies in our sector, which is not necessarily related to the performance of those companies;

price and volume fluctuations in the stock market as a result of terrorist attacks, or speculation regarding future terrorist attacks, in the United States or abroad;

actual or anticipated variations in our quarterly operating results or distributions to stockholders;

changes in our funds from operations or earnings estimates or the publication of research reports about us or the real estate industry generally;

actions by institutional stockholders;

speculation in the press or investment community;

changes in regulatory policies or tax guidelines, particularly with respect to REITs; and

investor confidence in the stock market.

*Shares of common stock eligible for future sale may have adverse effects on our share price.*

We cannot predict the effect, if any, of future sales of common stock, or the availability of shares for future sales, on the market price of our common stock. Sales of substantial amounts of common stock (including shares of common stock issuable upon the conversion of units of our operating partnership that we may issue from time to time or issuable upon conversion of our senior common stock), or the perception that these sales could occur, may adversely affect prevailing market prices for our common stock.

*Legislative or regulatory action could adversely affect investors.*

In recent years, numerous legislative, judicial and administrative changes have been made in the provisions of the federal and state income tax laws applicable to investments in REIT shares. Additional changes to tax laws are likely to continue to occur in the future, and we cannot assure you that any such changes will not adversely affect the taxation of our stockholders. Any such changes could have an adverse effect on an investment in our shares or on the market value or the resale potential of our properties.

*Compliance or failure to comply with laws requiring access to our properties by disabled persons could result in substantial cost.*

The Americans with Disabilities Act, or ADA, and other federal, state and local laws generally require public accommodations be made accessible to disabled persons. Noncompliance could result in the imposition of fines by the government or the award of damages to private litigants. These laws may require us to modify our existing properties. These laws may also restrict renovations by requiring improved access to such buildings by disabled persons or may require us to add other structural features which increase our construction costs. Legislation or regulations adopted in the future may impose further burdens or restrictions on us with respect to improved access by disabled persons. We may incur unanticipated



**Table of Contents**

expenses that may be material to our financial condition or results of operations to comply with ADA and other federal, state and local laws, or in connection with lawsuits brought by private litigants.

*Our Board of Directors may change our investment policy without stockholders' approval.*

Subject to our co-investment policy, our Board of Directors will determine its investment and financing policies, growth strategy and its debt, capitalization, distribution, acquisition, disposition and operating policies. Our Board of Directors may revise or amend these strategies and policies at any time without a vote by stockholders. Accordingly, stockholders' control over changes in our strategies and policies is limited to the election of directors, and changes made by our Board of Directors may not serve the interests of stockholders and could adversely affect our financial condition or results of operations, including our ability to distribute cash to stockholders or qualify as a REIT.

*If our Operating Partnership fails to maintain its status as a disregarded entity or partnership for federal income tax purposes, its income may be subject to taxation.*

As we hold all of the ownership interests in our Operating Partnership, it is currently disregarded for income tax purposes. We intend that it will qualify as a partnership for income tax purposes upon the admission of additional partners; however, if the IRS were to successfully challenge the status of our Operating Partnership as a partnership, it would be taxable as a corporation. In such event, this would reduce the amount of distributions that our Operating Partnership could make to us. This could also result in our losing REIT status and becoming subject to a corporate level tax on our income. This would substantially reduce our cash available to pay distributions and the return on your investment. In addition, if any of the entities through which our Operating Partnership owns its properties, in whole or in part, loses its characterization as a disregarded entity or a partnership for federal income tax purposes, it would be subject to taxation as a corporation, thereby reducing distributions to our Operating Partnership. Such a re-characterization of an underlying property owner could also threaten our ability to maintain REIT status.

*Joint venture investments could be adversely affected by our lack of sole decision making authority, our reliance on co-venturers' financial condition and disputes between our co-venturers and us.*

We may invest with third parties through partnerships, joint ventures or other entities, acquiring non-controlling interests in or sharing responsibility for managing the affairs of a property, partnership, joint venture or other entity. In such event, we will not have sole decision-making authority regarding the property, partnership, joint venture or other entity. Investments in partnerships, joint ventures or other entities may, under certain circumstances, involve risks not present were a third party not involved, including the possibility that partners or co-venturers may become bankrupt or fail to fund their share of required capital contributions. Partners or co-venturers also may have economic or other business interests or goals that are inconsistent with our business interests or goals and may be in a position to take actions contrary to our preferences, policies or objectives. Such investments also will have the potential risk of our reaching impasses with our partners or co-venturers on key decisions, such as a sale, because neither we nor the partner or co-venturer would have full control over the partnership or joint venture. Disputes between us and partners or co-venturers may result in litigation or arbitration that would increase our expenses and prevent our management team from focusing its time and effort exclusively on our business. In addition, we may in some circumstances be liable for the actions of our third-party partners or co-venturers.

*Our rights and the rights of our stockholders to take action against our directors and officers are limited.*

Maryland law provides that a director or officer has no liability in that capacity if he or she performs his or her duties in good faith, in a manner he or she reasonably believes to be advisable and in our best interests and with the care that an ordinarily prudent person in a like position would use under similar circumstances. In addition, our charter (i) eliminates our directors' and officers' liability to us and our stockholders for money damages except for liability resulting from actual receipt of an improper benefit in money, property or services or active and deliberate dishonesty established by a final judgment and that is material to the cause of action and (ii) requires us to indemnify directors and officers for liability resulting

**Table of Contents**

from actions taken by them in those capacities to the maximum extent permitted by Maryland law. As a result, our stockholders and we may have more limited rights against our directors and officers than might otherwise exist under common law. In addition, we may be obligated to fund the defense costs incurred by our directors and officers.

*Any weaknesses identified in our system of internal controls by us and our independent registered public accounting firm pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 could have an adverse effect on our business.*

Section 404 of the Sarbanes-Oxley Act of 2002 requires that public companies evaluate and report on their systems of internal control over financial reporting. In addition, our independent registered public accounting firm must report on management's evaluation of those controls. In future periods, we may identify deficiencies in our system of internal controls over financial reporting that may require remediation. There can be no assurances that any such future deficiencies identified may not be material weaknesses that would be required to be reported in future periods.

**Item 1B. Unresolved Staff Comments**

None.

**Table of Contents**

**Item 2. Properties**

The following table provides certain summary information about our 65 properties as of December 31, 2010.

35

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**Table of Contents**

| Property                                                   | Year Built/<br>Improvements | Date of<br>Purchase | Rentable<br>Square<br>Feet | Occupancy | Total Rental<br>Income for<br>the Year<br>Ended<br>December 31,<br>2010 <sup>(4)</sup> | Total<br>Rental<br>Income<br>per<br>Occupied<br>Square<br>Foot | Year<br>of<br>Lease<br>Expiration |
|------------------------------------------------------------|-----------------------------|---------------------|----------------------------|-----------|----------------------------------------------------------------------------------------|----------------------------------------------------------------|-----------------------------------|
| 208 South Rogers Lane (Raleigh NC)                         | 1997                        | 12/23/2003          | 58,926                     | 100%      | \$ 624,118                                                                             | \$ 10.59                                                       | 2015                              |
| 3874 Highland Park NW (Canton, OH)                         | 1994                        | 1/30/2004           | 54,018                     | 100%      | \$ 337,625                                                                             | \$ 6.25                                                        | 2014                              |
| 260 Springside Drive (Akron, OH)                           | 1968/1999                   | 4/29/2004           | 83,891                     | 100%      | \$ 1,026,692                                                                           | \$ 12.24                                                       | 2015 <sup>(1)</sup>               |
| 5815 Westpark Drive (Charlotte, NC)                        | 1984/1995                   | 6/30/2004           | 64,500                     | 100%      | \$ 1,006,553                                                                           | \$ 15.61                                                       | 2019                              |
| 171 Great Oak Drive (Canton, NC)                           | 1998                        | 7/6/2004            | 228,000                    | 100%      | \$ 600,145                                                                             | \$ 2.63                                                        | 2024                              |
| Rt. 219, Tax Parcel No. 33-251-0246, (Snyder Township, PA) | 1991                        | 8/5/2004            | 290,000                    | 100%      | \$ 930,522                                                                             | \$ 3.21                                                        | 2014                              |
| 9698 Old US Hwy. 52 (Lexington, NC)                        | 1986                        | 8/5/2004            | 154,000                    | 100%      | \$ 424,964                                                                             | \$ 2.76                                                        | 2014                              |
| 9100 Highway 290 East (Austin, TX)                         | 2001                        | 9/16/2004           | 51,933                     | 100%      | \$ 751,333                                                                             | \$ 14.47                                                       | 2015                              |
| 13 Industrial Park Drive (Mt. Pocono, PA)                  | 1995-1999                   | 10/15/2004          | 223,275                    | 100%      | \$ 637,025                                                                             | \$ 2.85                                                        | 2021                              |
| 6550 First Park Ten Boulevard (San Antonio, TX)            | 1999                        | 2/10/2005           | 60,245                     | 100%      | \$ 769,793                                                                             | \$ 12.78                                                       | 2014                              |
| 4630 Journal Street (Columbus, OH)                         | 1995                        | 2/10/2005           | 39,000                     | 100%      | \$ 308,105                                                                             | \$ 7.90                                                        | 2015                              |
| 199 Sing Sing Road (Big Flats, NY)                         | 2001                        | 4/15/2005           | 120,000                    | 100%      | \$ 644,252                                                                             | \$ 5.37                                                        | 2013                              |

|                                                 |                |            |         |      |    |           |    |       |      |
|-------------------------------------------------|----------------|------------|---------|------|----|-----------|----|-------|------|
| 2525 North Woodlawn Avenue (Wichita, KS)        | 2000           | 5/18/2005  | 69,287  | 100% | \$ | 1,109,217 | \$ | 16.01 | 2012 |
| 725 & 737 Great Southwest Pkwy (Arlington, TX)  | 1966           | 5/26/2005  | 64,000  | 100% | \$ | 580,635   | \$ | 9.07  | 2013 |
| 4032 Linden Avenue (Dayton, OH)                 | 1956           | 6/30/2005  | 59,894  | 100% | \$ | 268,042   | \$ | 4.48  | 2018 |
| 81 Corbett Way (Eatontown, NJ)                  | 1991           | 7/7/2005   | 30,268  | 100% | \$ | 537,321   | \$ | 17.75 | 2024 |
| 17 & 20 Veronica Avenue (Franklin Township, NJ) | 1978           | 7/11/2005  | 183,000 | 100% | \$ | 975,229   | \$ | 5.33  | 2020 |
| 150 Ridgeview Center Drive (Duncan, SC)         | 1984/2001/2007 | 7/14/2005  | 222,670 | 100% | \$ | 1,539,286 | \$ | 6.91  | 2020 |
| 170 Ridgeview Center Drive (Duncan, SC)         | 1984/2001/2007 | 7/14/2005  | 55,350  | 100% | \$ | 382,627   | \$ | 6.91  | 2020 |
| 5656 Campus Parkway (Hazelwood, MO)             | 1977           | 8/5/2005   | 51,155  | 100% | \$ | 289,928   | \$ | 5.67  | 2012 |
| 914 Wohler Street (Angola, IN)                  | 1982           | 9/2/2005   | 52,080  | 100% | \$ | 125,202   | \$ | 2.40  | 2020 |
| 800 Growth Parkway (Angola, IN)                 | 1998           | 9/2/2005   | 50,000  | 100% | \$ | 125,202   | \$ | 2.50  | 2020 |
| 802 East 11th Street (Rock Falls, IL)           | 1988           | 9/2/2005   | 52,000  | 100% | \$ | 125,202   | \$ | 2.41  | 2020 |
| 2 Opportunity Way (Newburyport, MA)             | 1994           | 10/17/2005 | 86,308  | 100% | \$ | 891,492   | \$ | 10.33 | 2015 |
| 255 Spring Street (Clintonville, WI)            | 1992           | 10/31/2005 | 291,142 | 100% | \$ | 575,006   | \$ | 1.98  | 2020 |
| 5700 Lee Road (Maple Heights, OH)               | 1974           | 12/21/2005 | 347,218 | 100% | \$ | 1,282,582 | \$ | 3.69  | 2015 |

|                                               |      |            |        |      |    |         |    |       |      |
|-----------------------------------------------|------|------------|--------|------|----|---------|----|-------|------|
| 7545 Midlothian<br>Turnpike<br>(Richmond, VA) | 1972 | 12/30/2005 | 42,213 | 0%   | \$ | 421,672 | \$ | 9.99  | 2010 |
| 3930 Sunforest<br>Court (Toledo, OH)          | 1979 | 12/30/2005 | 23,368 | 100% | \$ | 327,152 | \$ | 14.00 | 2020 |

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**Table of Contents**

| Property                                                | Year Built/<br>Improvements | Date of<br>Purchase | Rentable<br>Square<br>Feet | Occupancy | Total Rental<br>Income for<br>the Year<br>Ended<br>December 31,<br>2010 <sup>(4)</sup> | Total<br>Rental<br>Income<br>per<br>Occupied<br>Square<br>Foot | Year<br>of<br>Lease<br>Expiration |
|---------------------------------------------------------|-----------------------------|---------------------|----------------------------|-----------|----------------------------------------------------------------------------------------|----------------------------------------------------------------|-----------------------------------|
| 75 Canal Street<br>(South Hadley,<br>MA)                | 1978                        | 2/15/2006           | 150,000                    | 0%        | \$ 179,837                                                                             | \$ 1.20                                                        | 2010                              |
| 2101 Fox Drive<br>(Champaign, IL)                       | 1996                        | 2/21/2006           | 20,400                     | 100%      | \$ 295,220                                                                             | \$ 14.47                                                       | 2013                              |
| 2109 Fox Drive<br>(Champaign, IL)                       | 1996                        | 2/21/2006           | 40,000                     | 100%      | \$ 578,863                                                                             | \$ 14.47                                                       | 2013                              |
| 2215 Fox Drive<br>(Champaign, IL)                       | 1996                        | 2/21/2006           | 25,000                     | 100%      | \$ 361,790                                                                             | \$ 14.47                                                       | 2013                              |
| 2301 Fox Drive<br>(Champaign, IL)                       | 1996                        | 2/21/2006           | 22,862                     | 100%      | \$ 330,849                                                                             | \$ 14.47                                                       | 2013                              |
| 2470 Highcrest<br>Road (Roseville,<br>MN)               | 1964                        | 2/21/2006           | 359,540                    | 100%      | \$ 3,030,458                                                                           | \$ 8.43                                                        | 2012                              |
| 12000 Portland<br>Avenue South<br>(Burnsville, MN)      | 1984                        | 5/10/2006           | 114,100                    | 100%      | \$ 1,234,662                                                                           | \$ 10.82                                                       | 2015                              |
| 14701 Anthony<br>Avenue<br>(Menomonee Falls,<br>WI)     | 1986/2000                   | 6/30/2006           | 125,692                    | 100%      | \$ 775,274                                                                             | \$ 6.17                                                        | 2016                              |
| 1025 Birdsong<br>Drive (Baytown,<br>TX)                 | 1997                        | 7/11/2006           | 12,000                     | 100%      | \$ 254,121                                                                             | \$ 21.18                                                       | 2013                              |
| 42400 Merrill<br>Road (Sterling<br>Heights, MI)         | 1979/1989                   | 9/22/2006           | 532,869                    | 100%      | \$ 1,166,654                                                                           | \$ 2.19                                                        | 2016                              |
| 2150, 2200 Pinson<br>Valley Parkway<br>(Birmingham, AL) | 1961/1980                   | 9/29/2006           | 63,514                     | 100%      | \$ 271,173                                                                             | \$ 4.27                                                        | 2016                              |

|                                                   |           |            |         |      |    |           |    |       |                     |
|---------------------------------------------------|-----------|------------|---------|------|----|-----------|----|-------|---------------------|
| 2325 West<br>Fairview Avenue<br>(Montgomery, AL)  | 1962/1989 | 9/29/2006  | 29,472  | 100% | \$ | 125,830   | \$ | 4.27  | 2016                |
| 5221 N Highway<br>763 (Columbia,<br>MO)           | 1978      | 9/29/2006  | 16,275  | 100% | \$ | 69,486    | \$ | 4.27  | 2016                |
| 4690 Parkway<br>Drive (Mason,<br>OH)              | 2002      | 1/5/2007   | 60,000  | 100% | \$ | 681,270   | \$ | 11.35 | 2013                |
| 201 South Rogers<br>Lane (Raleigh,<br>NC)         | 1994      | 2/16/2007  | 115,500 | 100% | \$ | 717,203   | \$ | 6.21  | 2015                |
| 1110 West<br>Tenkiller (Tulsa,<br>OK)             | 2004      | 3/1/2007   | 238,310 | 100% | \$ | 1,565,794 | \$ | 6.57  | 2019 <sup>(3)</sup> |
| 3725 East 10th<br>Court (Hialeah,<br>FL)          | 1956/1992 | 3/9/2007   | 132,337 | 100% | \$ | 995,048   | \$ | 7.52  | 2022                |
| 554 Clark Road<br>(Tewksbury, MA)                 | 1985/1989 | 5/17/2007  | 102,200 | 100% | \$ | 922,926   | \$ | 9.03  | 2017                |
| 5324 Natorp<br>Boulevard (Mason,<br>OH)           | 2007      | 7/1/2007   | 21,264  | 100% | \$ | 583,131   | \$ | 27.42 | 2027                |
| 7282 Willam Barry<br>Boulevard (Cicero,<br>NY)    | 2005      | 9/6/2007   | 71,880  | 100% | \$ | 529,743   | \$ | 7.37  | 2020                |
| 1515 Arboretum<br>Drive SE (Grand<br>Rapids, MI)  | 2001      | 9/28/2007  | 63,235  | 100% | \$ | 1,068,550 | \$ | 16.90 | 2025                |
| 4 Territorial Court<br>(Bollingbrook, IL)         | 2002      | 9/28/2007  | 55,869  | 100% | \$ | 619,296   | \$ | 11.08 | 2014                |
| 2349<br>Lawrenceville<br>Highway (Decatur,<br>GA) | 1989      | 12/13/2007 | 16,740  | 100% | \$ | 404,159   | \$ | 24.14 | 2026                |
| 2341<br>Lawrenceville<br>Highway (Decatur,        | 1989      | 12/13/2007 | 4,372   | 100% | \$ | 105,555   | \$ | 24.14 | 2026                |

|                                                    |      |            |        |      |    |         |    |       |      |
|----------------------------------------------------|------|------------|--------|------|----|---------|----|-------|------|
| GA)                                                |      |            |        |      |    |         |    |       |      |
| 2339<br>Lawrenceville<br>Highway (Decatur,<br>GA)  | 1989 | 12/13/2007 | 5,488  | 100% | \$ | 132,498 | \$ | 24.14 | 2026 |
| 311 Phillip<br>Boulevard<br>(Lawrenceville,<br>GA) | 2005 | 12/13/2007 | 12,412 | 100% | \$ | 349,871 | \$ | 28.19 | 2026 |
| 2096 McGee Road<br>(Snellville, GA)                | 1986 | 12/13/2007 | 3,800  | 100% | \$ | 90,815  | \$ | 23.90 | 2026 |
|                                                    |      |            | 37     |      |    |         |    |       |      |

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**Table of Contents**

| Property                                         | Year Built/  |                  | Rentable    |           | Total Rental<br>Income for<br>the Year Ended<br>December 31, |  | Total<br>Rental<br>Income per<br>Occupied<br>Square<br>Foot | Year of<br>Lease<br>Expiration |
|--------------------------------------------------|--------------|------------------|-------------|-----------|--------------------------------------------------------------|--|-------------------------------------------------------------|--------------------------------|
|                                                  | Improvements | Date of Purchase | Square Feet | Occupancy | 2010 <sup>(4)</sup>                                          |  |                                                             |                                |
| 7174 Wheat<br>Street<br>(Covington,<br>GA)       | 2000         | 12/13/2007       | 5,000       | 100%      | \$ 119,493                                                   |  | \$ 23.90                                                    | 2026                           |
| 1055 Haw<br>Creek Parkway<br>(Cumming,<br>GA)    | 2004         | 12/13/2007       | 13,919      | 100%      | \$ 380,410                                                   |  | \$ 27.33                                                    | 2026                           |
| 1293 Wellbrook<br>Circle<br>(Conyers, GA)        | 1994         | 12/13/2007       | 6,400       | 100%      | \$ 152,951                                                   |  | \$ 23.90                                                    | 2026                           |
| 425 Gateway<br>Drive<br>(Reading, PA)            | 2007         | 1/29/2008        | 42,900      | 100%      | \$ 716,666                                                   |  | \$ 16.71                                                    | 2028                           |
| 6499 University<br>Avenue NE<br>(Fridley, MN)    | 1985/2006    | 2/26/2008        | 74,160      | 100%      | \$ 890,432                                                   |  | \$ 12.01                                                    | 2013 <sup>(3)</sup>            |
| 7528 Auburn<br>Road<br>(Concord<br>Township, OH) | 1957/2008    | 3/31/2008        | 273,300     | 100%      | \$ 1,724,133                                                 |  | \$ 6.31                                                     | 2028                           |
| 10021 Rodney<br>Street<br>(Pineville, NC)        | 1985         | 4/30/2008        | 74,950      | 100%      | \$ 431,424                                                   |  | \$ 5.76                                                     | 2028                           |
| 28305 State<br>Route 7<br>(Marietta, OH)         | 1992/2007    | 8/29/2008        | 223,458     | 100%      | \$ 896,743                                                   |  | \$ 4.01                                                     | 2028                           |
| 400 Highpoint<br>Drive<br>(Chalfont, PA)         | 1987         | 8/29/2008        | 67,200      | 100%      | \$ 757,571                                                   |  | \$ 11.27                                                    | 2016                           |
|                                                  | 1990         | 12/15/2010       | 487,121     | 100%      | \$ 53,215                                                    |  | \$ 2.37 <sup>(2)</sup>                                      | 2026                           |

1520 Albany  
Place SE  
(Orange City,  
Iowa)

**Totals** 6,791,280 **\$ 41,180,036**

- (1) Two tenants occupy this building, each with separate leases ending in the same year.
- (2) Rental income per occupied square foot is annualized, as if the building were held for all of 2010.
- (3) Property subject to a ground lease.
- (4) Total rental income included in this table is straight-line rental income calculated in accordance with US GAAP. The following table summarizes the lease expirations by year for our properties for leases in place as of December 31, 2010:

|              | Year of Lease<br>Expiration | Square Feet | Number<br>of<br>Leases <sup>(1)</sup> | Rental Revenue<br>for<br>the Year Ended<br>December 31,<br>2010 | % of<br>Annualized<br>Base Rent |
|--------------|-----------------------------|-------------|---------------------------------------|-----------------------------------------------------------------|---------------------------------|
| 2010         |                             | 192,213     | 2                                     | \$ 601,509                                                      | 1.5%                            |
| 2011         |                             |             | 0                                     |                                                                 | 0.0%                            |
| 2012         |                             | 479,982     | 3                                     | 4,429,603                                                       | 10.8%                           |
| 2013         |                             | 438,422     | 6                                     | 4,617,432                                                       | 11.2%                           |
| 2014         |                             | 614,132     | 5                                     | 3,082,200                                                       | 7.5%                            |
| 2015         |                             | 896,876     | 8                                     | 6,836,187                                                       | 16.6%                           |
| 2016         |                             | 835,022     | 4                                     | 3,165,988                                                       | 7.7%                            |
| 2017         |                             | 102,200     | 1                                     | 922,926                                                         | 2.2%                            |
| 2018         |                             | 59,894      | 1                                     | 268,042                                                         | 0.7%                            |
| 2019+        |                             | 3,172,539   | 22                                    | 17,256,149                                                      | 41.8%                           |
| <b>Total</b> |                             | 6,791,280   | 52                                    | \$ 41,180,036                                                   | 100%                            |

- (1) Two leases expired during the third quarter of 2010, and neither of these properties have yet to be re-leased. The following table summarizes the geographic locations of our properties for leases in place as of December 31, 2010:

**Table of Contents**

| State            | Square Feet | Number<br>of<br>Leases <sup>(1)</sup> | Rental Revenue<br>for<br>the Year Ended<br>December 31,<br>2010 | % of<br>Annualized<br>Base Rent |
|------------------|-------------|---------------------------------------|-----------------------------------------------------------------|---------------------------------|
| Ohio             | 1,185,411   | 11                                    | 7,435,475                                                       | 18.1%                           |
| Minnesota        | 547,800     | 3                                     | 5,155,552                                                       | 12.5%                           |
| North Carolina   | 695,876     | 6                                     | 3,804,407                                                       | 9.2%                            |
| Pennsylvania     | 623,375     | 4                                     | 3,041,784                                                       | 7.4%                            |
| Texas            | 188,178     | 4                                     | 2,355,882                                                       | 5.7%                            |
| Michigan         | 596,104     | 2                                     | 2,235,204                                                       | 5.4%                            |
| Illinois         | 164,131     | 2                                     | 2,186,018                                                       | 5.3%                            |
| Massachusetts    | 338,508     | 3                                     | 1,994,255                                                       | 4.8%                            |
| All Other States | 2,451,897   | 17                                    | 12,971,459                                                      | 31.6%                           |
| <b>Total</b>     | 6,791,280   | 52                                    | \$ 41,180,036                                                   | 100%                            |

<sup>(1)</sup> Two leases expired during the third quarter of 2010, and neither of these properties have yet to be re-leased.

**Item 3. Legal Proceedings**

We are not currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us.

**Item 4. Removed and Reserved**

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is traded on the Nasdaq Global Select Market under the symbol GOOD. The following table reflects the range of the high and low sale prices of our common stock on the Nasdaq Global Select Market and the distributions per share for the years ended December 31, 2010 and 2009. Distributions to stockholders are declared quarterly and paid monthly. Amounts presented represent the cumulative amount of the distributions declared for the months composing such quarter.

| Quarter Ended | Market price per share |         | Distributions Declared Per Share |
|---------------|------------------------|---------|----------------------------------|
|               | High                   | Low     |                                  |
| 3/31/2009     | \$ 10.20               | \$ 5.36 | \$ 0.375                         |
| 6/30/2009     | 16.21                  | 8.20    | 0.375                            |
| 9/30/2009     | 14.50                  | 11.26   | 0.375                            |
| 12/31/2009    | 14.19                  | 11.85   | 0.375                            |
| 3/31/2010     | 14.87                  | 13.05   | 0.375                            |
| 6/30/2010     | 17.79                  | 14.36   | 0.375                            |
| 9/30/2010     | 17.30                  | 15.61   | 0.375                            |
| 12/31/2010    | 19.50                  | 17.00   | 0.375                            |

Since inception, we have never reduced our per-share distributions nor have we missed payment of a scheduled distribution to our stockholders. Our Board of Directors regularly evaluates our per share distribution payments as they monitor the capital markets and the impact that the economy has upon us. The decision as to whether to authorize and pay distributions on shares of our common stock in the future, as well as the timing, amount and composition of any such future distributions, will be at the sole and absolute discretion of our Board of Directors in light of conditions then existing, including our earnings, FFO, financial condition, liquidity, capital requirements, debt maturities, the availability of capital, contractual prohibitions or other restrictions, applicable REIT and legal restrictions and general overall economic conditions and other factors. While the statements above concerning our distribution policy represent our current expectations, any actual distribution payable will be determined by our Board of Directors based upon the circumstances at the time of declaration and the actual number of shares then outstanding, and any distribution payable may vary from such expected amounts.

In order to qualify as a REIT, we are required to make ordinary dividend distributions to our stockholders. The amount of these distributions must equal at least:

- the sum of (A) 90% of our REIT taxable income (computed without regard to the dividends paid deduction and capital gain) and (B) 90% of the net income (after tax), if any, from foreclosure property, less
- the sum of certain non-cash items.

For federal income tax purposes, our distributions generally consist of ordinary income, capital gains, nontaxable return of capital or a combination of those items. Distributions that exceed our current and accumulated earnings and profits (calculated for tax purposes) constitute a return of capital rather than a dividend, which reduces a stockholder's basis in its shares of stock and will not be taxable to the extent of the stockholder's basis in its shares of our stock. To the extent a distribution exceeds the stockholder's share of both our current and accumulated earnings and profits and the stockholder's basis in its shares of our stock, that distribution will be treated as a gain from the sale or exchange of that stockholder's shares of our stock. Every year, we notify stockholders of the taxability of distributions paid to stockholders during the preceding year.

**Table of Contents**

As of February 7, 2011, there were approximately 7,921 beneficial owners of our common stock. On November 19, 2009, the Company entered into a dealer manager agreement, as amended and restated on December 22, 2009, or the Dealer Manager Agreement, with Halcyon Capital Markets, LLC, or Halcyon, pursuant to which Halcyon agreed to act as the Company's dealer manager in connection with the Company's continuous private offering of up to 3,333,333 shares of its then newly-designated unregistered senior common stock, par value \$0.001 per share, at a price of \$15.00 per share to investors and a selling commission of \$1.6125 per share. On October 19, 2010, the Company terminated the private offering of unregistered senior common stock, including the related dividend reinvestment plan for such senior common stock. The Company issued 59,057 shares of unregistered senior common stock pursuant to the private offering and related dividend reinvestment plan. These issuances were exempt from registration pursuant to the Securities Act and to Rule 506 thereunder, among other exemptions, on the basis that the securities were sold in a private offering not involving general solicitation and that the purchasers of the securities were accredited investors. Net proceeds from these sales, after selling commissions and dealer manager fees, were approximately \$787,000.

**Table of Contents****Item 6. Selected Financial Data**

The following selected financial data for the fiscal years ended December 31, 2010, 2009, 2008, 2007 and 2006 is derived from our audited consolidated financial statements. Certain amounts from prior years' financial statements have been reclassified to discontinued operations and these reclassifications had no effect on previously reported net income or stockholders' equity. The data should be read in conjunction with our consolidated financial statements and notes thereto, included elsewhere in this report, and Management's Discussion and Analysis of Financial Condition and Results of Operations included in Item 7 of this report.

|                                               | 2010          | For the year ended December 31, |               |               |               |
|-----------------------------------------------|---------------|---------------------------------|---------------|---------------|---------------|
|                                               |               | 2009                            | 2008          | 2007          | 2006          |
| <b>Operating Data:</b>                        |               |                                 |               |               |               |
| Total operating revenue                       | \$ 41,928,070 | \$ 42,608,937                   | \$ 40,807,497 | \$ 32,690,038 | \$ 25,842,045 |
| Total operating expenses                      | (23,414,572)  | (20,540,529)                    | (19,363,723)  | (15,791,430)  | (14,035,669)  |
| Other expense                                 | (13,585,590)  | (17,668,460)                    | (16,570,753)  | (10,940,394)  | (8,521,419)   |
| Income from continuing operations             | 4,927,908     | 4,399,948                       | 4,873,021     | 5,958,214     | 3,284,957     |
| Discontinued operations                       |               | 203,100                         | 39,926        | 182,015       | 1,087,871     |
| Net income                                    | \$ 4,927,908  | \$ 4,603,048                    | \$ 4,912,947  | \$ 6,140,229  | \$ 4,372,828  |
| Dividends attributable to preferred stock     | (4,093,750)   | (4,093,750)                     | (4,093,750)   | (4,093,750)   | (2,186,890)   |
| Dividends attributable to senior common stock | (20,050)      |                                 |               |               |               |
| Net income available to common stockholders   | \$ 814,108    | \$ 509,298                      | \$ 819,197    | \$ 2,046,479  | \$ 2,185,938  |

**Share and Per Share Data:**

|                                                                                      |         |         |         |         |         |
|--------------------------------------------------------------------------------------|---------|---------|---------|---------|---------|
| Earnings per weighted average common share - basic                                   |         |         |         |         |         |
| Income from continuing operations (net of dividends attributable to preferred stock) | \$ 0.09 | \$ 0.04 | \$ 0.09 | \$ 0.22 | \$ 0.14 |
| Discontinued operations                                                              |         | 0.02    | 0.01    | 0.02    | 0.14    |
| Net income available to common stockholders                                          | \$ 0.09 | \$ 0.06 | \$ 0.10 | \$ 0.24 | \$ 0.28 |

|                                                                                      |         |         |         |         |         |
|--------------------------------------------------------------------------------------|---------|---------|---------|---------|---------|
| Earnings per weighted average common share - diluted                                 |         |         |         |         |         |
| Income from continuing operations (net of dividends attributable to preferred stock) | \$ 0.09 | \$ 0.04 | \$ 0.09 | \$ 0.22 | \$ 0.14 |

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|                                                                                    |    |             |      |             |      |             |      |             |      |             |
|------------------------------------------------------------------------------------|----|-------------|------|-------------|------|-------------|------|-------------|------|-------------|
| Discontinued operations                                                            |    |             | 0.02 |             | 0.01 |             | 0.01 |             | 0.13 |             |
| Net income available to common stockholders                                        | \$ | 0.09        | \$   | 0.06        | \$   | 0.10        | \$   | 0.23        | \$   | 0.27        |
| Weighted average shares outstanding-basic                                          |    | 8,576,303   |      | 8,563,264   |      | 8,565,149   |      | 8,565,264   |      | 7,827,781   |
| Weighted average shares outstanding-diluted                                        |    | 8,601,153   |      | 8,563,264   |      | 8,565,149   |      | 8,565,264   |      | 7,986,690   |
| Cash dividends declared per common share                                           | \$ | 1.50        | \$   | 1.50        | \$   | 1.50        | \$   | 1.44        | \$   | 1.44        |
| <b>Supplemental Data:</b>                                                          |    |             |      |             |      |             |      |             |      |             |
| Net income available to common stockholders                                        | \$ | 814,108     | \$   | 509,298     | \$   | 819,197     | \$   | 2,046,479   | \$   | 2,185,938   |
| Real estate depreciation and amortization, including discontinued operations       |    | 13,263,814  |      | 13,171,703  |      | 12,704,641  |      | 10,528,458  |      | 8,349,474   |
| Less: Gain on sale of real estate, net of taxes paid                               |    |             |      | (160,038)   |      |             |      | (78,667)    |      | (1,106,590) |
| Funds from operations available to common stockholders <sup>(1)</sup>              |    | 14,077,922  |      | 13,520,963  |      | 13,523,838  |      | 12,496,270  |      | 9,428,822   |
| Ratio of earnings to combined fixed charges and preferred dividends <sup>(2)</sup> |    | 1.0x        |      | 1.0x        |      | 1.1x        |      | 1.1x        |      | 1.1x        |
| <b>Balance Sheet Data:</b>                                                         |    |             |      |             |      |             |      |             |      |             |
| Real estate, before accumulated depreciation                                       | \$ | 401,016,940 | \$   | 390,753,892 | \$   | 390,562,138 | \$   | 340,500,406 | \$   | 243,713,542 |
| Total assets                                                                       | \$ | 410,608,602 | \$   | 416,865,373 | \$   | 429,098,785 | \$   | 378,902,689 | \$   | 315,766,022 |
| Mortgage notes payable, term loan and borrowings under the line of credit          | \$ | 287,869,463 | \$   | 285,961,651 | \$   | 286,611,173 | \$   | 226,520,471 | \$   | 154,494,438 |
| Total stockholders equity                                                          | \$ | 111,374,307 | \$   | 118,450,542 | \$   | 130,495,260 | \$   | 142,368,068 | \$   | 152,224,176 |
| Total common shares outstanding                                                    |    | 8,724,613   |      | 8,563,264   |      | 8,565,149   |      | 8,565,264   |      | 8,565,264   |

(1) FFO was developed by The National Association of Real Estate Investment Trusts ( NAREIT ), as a relative non-GAAP ( Generally Accepted Accounting Principles in the United States ) supplemental measure of operating performance of an equity REIT in order to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. FFO, as defined by NAREIT, is net income (loss) (computed in accordance with GAAP), excluding gains (or losses) from sales of property, plus depreciation and amortization of real estate assets, and after adjustments for unconsolidated partnerships and joint ventures. FFO does not represent cash flows from operating activities in accordance with GAAP and should not be considered an alternative to either net income (loss) as an indication of our performance or to cash flow from operations as a measure of liquidity or ability to make distributions to stockholders. Comparison of FFO to similarly titled measures for other REITs may not necessarily be meaningful due to possible differences in the application of the NAREIT definition used by such REITs.

FFO available to common stockholders is FFO adjusted to subtract preferred share and senior common share distributions. We believe that net income available to common stockholders is the most directly comparable GAAP measure to FFO available to common stockholders.

Basic funds from operations per share, or Basic FFO per share, and diluted funds from operations per share, or Diluted FFO per share, is FFO available to common stockholders divided by weighted average common shares outstanding and FFO available to common stockholders divided by weighted average common shares outstanding on a diluted basis, respectively, during a period. We believe that FFO available to common stockholders, Basic FFO per share and Diluted FFO per share are useful to investors because they provide investors with a further context for evaluating our

**Table of Contents**

FFO results in the same manner that investors use net income and earnings per share, or EPS, in evaluating net income available to common stockholders. In addition, since most REITs provide FFO available to common stockholders, Basic FFO and Diluted FFO per share information to the investment community, we believe these are useful supplemental measures for comparing us to other REITs. We believe that net income is the most directly comparable GAAP measure to FFO, Basic EPS is the most directly comparable GAAP measure to Basic FFO per share, and that diluted EPS is the most directly comparable GAAP measure to Diluted FFO per share.

The following table provides a reconciliation of our FFO for the years ended December 31, 2010, 2009, 2008, 2007 and 2006 to the most directly comparable GAAP measure, net income, and a computation of basic and diluted FFO per weighted average common share and basic and diluted net income per weighted average common share:

|                                                                                   | For the year ended December 31, |               |               |               |              |
|-----------------------------------------------------------------------------------|---------------------------------|---------------|---------------|---------------|--------------|
|                                                                                   | 2010                            | 2009          | 2008          | 2007          | 2006         |
| Net income                                                                        | \$ 4,927,908                    | \$ 4,603,048  | \$ 4,912,947  | \$ 6,140,229  | \$ 4,372,828 |
| Less: Distributions attributable to preferred and senior common stock             | (4,113,800)                     | (4,093,750)   | (4,093,750)   | (4,093,750)   | (2,186,890)  |
| Net income available to common stockholders                                       | 814,108                         | 509,298       | 819,197       | 2,046,479     | 2,185,938    |
| Add: Real estate depreciation and amortization, including discontinued operations | 13,263,814                      | 13,171,703    | 12,704,641    | 10,528,458    | 8,349,474    |
| Less: Gain on sale of real estate                                                 |                                 | (160,038)     |               | (78,667)      | (1,106,590)  |
| FFO available to common stockholders                                              | \$ 14,077,922                   | \$ 13,520,963 | \$ 13,523,838 | \$ 12,496,270 | \$ 9,428,822 |
| Weighted average shares outstanding basic                                         | 8,576,303                       | 8,563,264     | 8,565,149     | 8,565,264     | 7,827,781    |
| Weighted average shares outstanding diluted                                       | 8,601,153                       | 8,563,264     | 8,565,149     | 8,565,264     | 7,986,690    |
| Basic net income per weighted average share of common stock                       | \$ 0.09                         | \$ 0.06       | \$ 0.10       | \$ 0.24       | \$ 0.28      |
| Diluted net income per weighted average share of common stock                     | \$ 0.09                         | \$ 0.06       | \$ 0.10       | \$ 0.24       | \$ 0.27      |
| Basic FFO per weighted average share of common stock                              | \$ 1.64                         | \$ 1.58       | \$ 1.58       | \$ 1.46       | \$ 1.20      |

|                                                        |    |      |    |      |    |      |    |      |    |      |
|--------------------------------------------------------|----|------|----|------|----|------|----|------|----|------|
| Diluted FFO per weighted average share of common stock | \$ | 1.64 | \$ | 1.58 | \$ | 1.58 | \$ | 1.46 | \$ | 1.18 |
| Distributions declared per share of common stock       | \$ | 1.50 | \$ | 1.50 | \$ | 1.50 | \$ | 1.44 | \$ | 1.44 |
| Percentage of FFO paid per share of common stock       |    | 91%  |    | 95%  |    | 95%  |    | 99%  |    | 120% |

- (2) The calculation of the ratio of earnings to combined fixed charges and preferred distributions is below. Earnings consist of net income from continuing operations before fixed charges. Fixed charges consist of interest expense, amortization of deferred financing fees and the portion of operating lease expense that represents interest. The portion of operating lease expense that represents interest is calculated by dividing the amount of rent expense, allocated to us by our Adviser as part of the administration fee payable under the Advisory Agreement, by three.

|                                                                         | For the year ended December 31, |               |               |               |               |
|-------------------------------------------------------------------------|---------------------------------|---------------|---------------|---------------|---------------|
|                                                                         | 2010                            | 2009          | 2008          | 2007          | 2006          |
| Net income from continuing operations                                   | \$ 4,927,908                    | \$ 4,399,948  | \$ 4,873,021  | \$ 5,958,214  | \$ 3,284,957  |
| Add: fixed charges                                                      | 21,191,303                      | 22,000,728    | 20,963,484    | 15,670,067    | 11,490,476    |
| Less: preferred and senior common distributions                         | (4,113,800)                     | (4,093,750)   | (4,093,750)   | (4,093,750)   | (2,186,890)   |
| Earnings                                                                | \$ 22,005,411                   | \$ 22,306,926 | \$ 21,742,755 | \$ 17,534,531 | \$ 12,588,543 |
| Fixed Charges:                                                          |                                 |               |               |               |               |
| Interest expense                                                        | 16,031,755                      | 16,398,938    | 15,574,735    | 10,847,346    | 8,041,412     |
| Amortization of deferred financing fees                                 | 1,030,982                       | 1,495,598     | 1,283,952     | 717,195       | 1,207,198     |
| Estimated interest component of rent                                    | 14,766                          | 12,442        | 11,047        | 11,776        | 54,976        |
| Preferred and senior common distributions                               | 4,113,800                       | 4,093,750     | 4,093,750     | 4,093,750     | 2,186,890     |
| Total fixed charges and preferred distributions                         | 21,191,303                      | 22,000,728    | 20,963,484    | 15,670,067    | 11,490,476    |
| Ratio of earnings to combined fixed charges and preferred distributions | 1.0                             | 1.0           | 1.0           | 1.1           | 1.1           |

**Table of Contents**

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the notes thereto contained elsewhere in this Form 10-K.*

**OVERVIEW**

**General**

We were incorporated under the General Corporation Law of the State of Maryland on February 14, 2003, primarily for the purpose of investing in and owning net leased industrial and commercial real property and selectively making long-term industrial and commercial mortgage loans. Most of the portfolio of real estate that we currently own is leased to a wide cross section of tenants ranging from small businesses to large public companies, many of which are corporations that do not have publicly-rated debt. We have historically entered into, and intend in the future to enter into, purchase agreements for real estate having triple net leases with terms of approximately 10 to 15 years and built in rental rate increases. Under a triple net lease, the tenant is required to pay all operating, maintenance and insurance costs and real estate taxes with respect to the leased property. We are actively communicating with buyout funds, real estate brokers and other third parties to locate properties for potential acquisition or to provide mortgage financing in an effort to build our portfolio. At December 31, 2010, we owned 65 properties totaling approximately 6.8 million square feet. The total gross investment in these properties was approximately \$446.4 million at December 31, 2010.

**Business Environment**

The United States is beginning to recover from the recession that it entered into during late 2007, though it continues to experience pervasive and fundamental disruptions in its financial and capital markets. Unemployment remains high and housing starts are low, and these key economic indicators will need to improve in order for the economy to fully recover. As a result, conditions within the U.S. capital markets generally, and the U.S. real estate capital markets particularly, continue to experience significant dislocation and stress. While we are seeing signs of stabilization in both the equity and debt capital markets, these markets remain challenging and we do not know if adverse conditions will again intensify, nor are we able to gauge the full extent to which the disruptions will affect us. We believe that it will take some time for the United States to fully recover from the recession.

As a result, the continued challenging economic conditions could still materially and adversely impact the financial condition of one or more of our tenants and, therefore, could increase the likelihood that a tenant may declare bankruptcy or default upon its payment obligations arising under a related lease.

Moreover, our ability to make new investments is highly dependent upon our ability to procure external financing. Our principal sources of external financing generally include the issuance of equity securities, long-term mortgages secured by properties, and borrowings under our line of credit. The market for long-term mortgages has been limited, as the collateralized mortgage-backed securities, or CMBS, market has experienced significant disruption. With the stresses upon the CMBS market, many banks are not lending on industrial and commercial real estate as they are no longer able to sell these loans to the CMBS market and are not willing or able to keep these loans on their balance sheets. In addition, many banks have significantly curtailed their general lending practices, as they are having difficulty valuing the underlying real estate in this market. We are, however, beginning to see banks that are willing to issue medium-term mortgages, between two and five years, on substantially less favorable terms than were previously available. Consequently, we continue to focus on using medium-term mortgages to finance our real estate activities until the market for long-term mortgages returns.

## **Table of Contents**

### **Recent Developments**

#### *Investment Activities:*

On April 15, 2005, we originated a mortgage loan in the amount of \$10.0 million that was collateralized by an office building located in McLean, Virginia in which Gladstone Management Corporation, or our Adviser, and Gladstone Administration LLC, or our Administrator, are subtenants. The mortgage loan was originally set to mature in May 2017, though, on July 22, 2010, it was fully repaid. We received \$3.3 million of additional income and prepayment fees in connection with the early payment and the proceeds were used to repay a portion of our line of credit.

During the year ended December 31, 2010, we acquired one property. The property is a 487,121 square foot office/industrial building located in Orange City, Iowa for approximately \$12.3 million, including related acquisition expenses. We funded this acquisition through a combination of borrowings from the New Line of Credit and the assumption of approximately \$10.8 million of mortgage debt on the property. At closing, the seller assigned to us the existing triple net lease with Staples Contract & Commercial, Inc., the commercial delivery and fulfillment division of Staples, Inc. The existing triple net lease has a remaining term of approximately sixteen years, and the mortgage debt related to the property matures in December 2026. The existing triple net lease provides for aggregate rents of approximately \$1.2 million in 2011 with prescribed annual rental rate escalations commencing in 2012.

#### *Financing Activities:*

In December 2010, we procured a new line of credit, or the New Line of Credit, with Capital One, N.A. serving as a revolving lender, a letter of credit issuer and as an administrative agent and Branch Banking and Trust Company serving as a revolving lender and a letter of credit issuer, which matures on December 28, 2013. The New Line of Credit replaced our prior \$50.0 million senior secured revolving credit facility which was scheduled to mature on December 29, 2010, or the Prior Line of Credit. The New Line of Credit provides for a senior secured revolving credit facility of up to \$50.0 million, with a standby letter of credit sublimit of up to \$20.0 million. The New Line of Credit is subject to a maximum borrowing base calculation which may, from time to time, affect the maximum amount available to be drawn. The New Line of Credit may, upon satisfaction of certain conditions, be expanded up to \$75.0 million.

In connection with procuring the New Line of Credit, we repaid the \$29.8 million outstanding balance of the Prior Line of Credit with funds drawn from the New Line of Credit and with existing cash. We incurred no early termination penalties or fees in connection with the repayment of outstanding balance of the Prior Line of Credit. There was \$27.0 million outstanding under the line at December 31, 2010, and we had an available borrowing capacity of \$5.9 million thereunder at December 31, 2010.

#### *Debt Activities:*

We had \$48.0 million of balloon principal payments maturing under one of our long-term mortgages in 2010; however, the mortgage has three annual extension options through 2013, and we exercised one of these options on September 30, 2010. In connection with the exercise of the option, the interest rate reset from 6.85% to 4.58%. At the time of notification of extension, we remitted a fee of 0.25% of the outstanding principal balance, or \$120,000, and a certification to the lender that our aggregate debt service coverage ratio is not less than 1.2. The interest rate for the two additional extension periods will adjust based upon the 1-year swap rate at the time of extension and a fixed spread of 4.29% and 4.41%, respectively. We expect to exercise our remaining two annual extension options as they come due in 2011 and 2012. We have no other balloon principal payments due under any of our mortgages until 2013.

## **Table of Contents**

### *Equity Activities:*

We raised approximately \$3.4 million in net proceeds during 2010 under our open market sale agreement, or the Open Market Sale Agreement, with Jefferies & Company, Inc., or Jefferies. Under this agreement we may, from time to time, offer to sell shares of our common stock with an aggregate sales price of up to \$25.0 million on the open market through Jefferies, as agent, or to Jefferies, as principal based upon our instructions (including any price, time or size limits or other customary parameters or conditions that we may impose). Sales of shares of our common stock through Jefferies will be executed by means of ordinary brokers' transactions on the NASDAQ Global Select Market or otherwise at market prices, in privately negotiated transactions, crosses or block transactions, as may be agreed between us and Jefferies, including a combination of any of these transactions. We will pay Jefferies a commission equal to 2.0% of the gross sales proceeds of any common stock sold through Jefferies as agent under the Open Market Sale Agreement, and currently we have paid commission to Jefferies of approximately \$65,000. To date, we have sold 192,365 shares of common stock under the Open Market Sale Agreement. The proceeds were used to repay a portion of our Prior Line of Credit and fund the acquisition of the property in Orange City, Iowa.

On November 19, 2009, we entered into a dealer manager agreement, or the Dealer Manager Agreement, as amended and restated on December 22, 2009, with Halcyon Capital Markets, LLC, or Halcyon, pursuant to which Halcyon agreed to act as our dealer manager in connection with our continuous private offering of up to 3,333,333 shares of our then newly designated unregistered senior common stock at \$15.00 per share. Holders of the unregistered senior common stock have the right, but not the obligation, following the fifth anniversary of the issuance of such shares, to exchange any or all of such shares of senior common stock for shares of our common stock. On October 19, 2010, we terminated the private offering of unregistered senior common stock, including the dividend reinvestment plan for the senior common stock. In connection with the termination, we wrote-off approximately \$1.6 million of fees incurred in relation to the offering. The expenses consisted primarily of legal, accounting and fees paid to Halcyon, and are recorded as professional fees in our consolidated statement of operations. We issued 59,057 shares of unregistered senior common stock pursuant to the private offering and related dividend reinvestment plan. Net proceeds from these sales, after selling commissions and dealer manager fees, were approximately \$787,000.

On February 2, 2011, we sold 725,000 shares of our common stock at \$18.35 per share in an underwritten public offering of our common stock. Subsequently, on February 16, 2011, we sold an additional 108,750 shares of common stock on the same terms and conditions in connection with the underwriters' exercise of their over-allotment option. The net proceeds after deducting the underwriting discount and estimated offering expenses were approximately \$14.3 million. We used the proceeds of the offering to repay a portion of the outstanding balance under our New Line of Credit. The shares were issued under our effective shelf registration statement on file with the Securities and Exchange Commission, or SEC.

### *Leasing Activities:*

On May 4, 2010, we extended the lease with the tenant that occupies our property located in Grand Rapids, Michigan for a period of 15 years, and the tenant has 2 options to extend the lease for additional periods of 10 years each. The lease was originally set to expire in July 2016, and will now expire in April 2025. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$1.1 million.

On June 30, 2010 and July 31, 2010, respectively, the leases with the tenants that occupied our properties located in South Hadley, Massachusetts and Richmond, Virginia, respectively, expired and currently remain vacant. These two leases comprised approximately 2.6% of our total annualized rental income. We are actively seeking new tenants for these two properties while concurrently researching alternative uses for these two properties.

On September 29, 2010, the tenant in our building located in Hazelwood, Missouri declared bankruptcy. The lease for this property is scheduled to expire in January 2012, and rental income from this tenant comprises less than 1% of our total annualized rental income. On March 2, 2011, the lease was rejected

**Table of Contents**

in the bankruptcy proceedings of our tenant. We have been informed that the rent payments will cease at the end of April 2011. We are taking the appropriate action to re-tenant the property.

On October 8, 2010, we extended the lease with the tenant that occupies our property located in Toledo, Ohio for a period of 10 years, and the tenant has 2 options to extend the lease for additional periods of 10 years each. The lease was originally set to expire in December 2010, and will now expire in December 2020. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$276,000.

On December 14, 2010, we released the current tenant in our property located in Cumming, Georgia from its obligations under their existing lease, and simultaneously signed a lease with a new tenant under substantially the same terms. The new tenant is an Atlanta, Georgia based hospital system that acquired part of the current tenant's business, part of which is housed in our Cumming, Georgia facility. The current tenant is a medical group that continues to lease the remainder of our properties located in Georgia under a master lease. In connection with services provided directly by our Adviser to the tenant, the tenant paid a real estate advisory fee to our Adviser, in the amount of \$450,000.

On December 30, 2010, we extended the lease with the tenant that occupies our property located in Fridley, Minnesota for a period of 10 years, and the tenant has one option to extend the lease for a period of 5 years. The lease was originally set to expire in January 2013 and will now expire in July 2020. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$812,000.

On January 31, 2011, we extended the lease with our tenant occupying five of our properties located in Decatur, Georgia, Lawrenceville, Georgia, Snellville, Georgia, Covington, Georgia, and Conyers, Georgia. The lease covering all of these properties was extended for an additional five year period, thereby extending the lease until December 2031. The lease was originally set to expire in December 2026. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$1.6 million. Furthermore, the lease grants the tenant four options to extend the lease for a period of five years each.

All of our remaining tenants are current and paying in accordance with their leases.

**Diversity of Our Portfolio**

Gladstone Management Corporation, or our Adviser, seeks to diversify our portfolio to avoid dependence on any one particular tenant, geographic market or tenant industry. By diversifying our portfolio, our Adviser intends to reduce the adverse effect on our portfolio of a single under-performing investment or a downturn in any particular industry or geographic market. Our largest tenant at December 31, 2010 comprised approximately 7.4% of our total rental income, and our largest concentration of properties was located in Ohio, which accounted for approximately 18.1% of our total rental income. The table below reflects the breakdown of our total rental income by tenant industry classification for the years ended December 31, 2010 and 2009, respectively:

**Table of Contents**

|                                          | <b>December 31, 2010</b> |                  | <b>December 31, 2009</b> |                  |
|------------------------------------------|--------------------------|------------------|--------------------------|------------------|
|                                          |                          | Percentage<br>of |                          | Percentage<br>of |
| Industry Classification                  | Rental<br>Income         | Rental<br>Income | Rental<br>Income         | Rental<br>Income |
| Electronics                              | \$ 6,165,788             | 15.0%            | \$ 6,164,789             | 14.9%            |
| Healthcare, Education & Childcare        | 6,145,415                | 14.9%            | 6,145,415                | 14.8%            |
| Telecommunications                       | 5,447,365                | 13.3%            | 5,447,033                | 13.1%            |
| Diversified/Conglomerate Manufacturing   | 3,664,686                | 8.9%             | 3,664,686                | 8.8%             |
| Chemicals, Plastics & Rubber             | 3,130,133                | 7.6%             | 3,173,514                | 7.6%             |
| Machinery                                | 2,332,672                | 5.7%             | 2,389,607                | 5.8%             |
| Containers, Packaging & Glass            | 2,330,715                | 5.7%             | 2,330,246                | 5.6%             |
| Beverage, Food & Tobacco                 | 2,188,793                | 5.2%             | 2,188,755                | 5.3%             |
| Printing & Publishing                    | 2,187,504                | 5.3%             | 2,189,033                | 5.3%             |
| Buildings and Real Estate                | 2,075,103                | 5.0%             | 2,025,668                | 4.9%             |
| Oil & Gas                                | 1,282,582                | 3.1%             | 1,138,136                | 2.7%             |
| Personal & Non-Durable Consumer Products | 1,228,100                | 2.9%             | 1,354,721                | 3.3%             |
| Automobile                               | 1,166,654                | 2.8%             | 1,166,654                | 2.8%             |
| Personal, Food & Miscellaneous Services  | 575,006                  | 1.4%             | 575,006                  | 1.4%             |
| Home & Office Furnishings                | 529,743                  | 1.3%             | 529,743                  | 1.3%             |
| Insurance                                | 421,672                  | 1.0%             | 722,866                  | 1.7%             |
| Diversified/Conglomerate Services        | 308,105                  | 0.9%             | 308,105                  | 0.7%             |
|                                          | \$ 41,180,036            | 100.0%           | \$ 41,513,977            | 100.0%           |

**Our Adviser and Administrator**

Our Adviser is led by a management team which has extensive experience purchasing real estate and originating mortgage loans. Our Adviser is controlled by Mr. David Gladstone, our chairman and chief executive officer. Mr. Gladstone is also the chairman and chief executive officer of our Adviser. Terry Lee Brubaker, our vice chairman, chief operating officer, secretary and director, is a member of the board of directors of our Adviser as well as its vice chairman and chief operating officer. George Stelljes III, our president, chief investment officer and director, is a member of the board of directors of our Adviser and its president and chief investment officer. Gladstone Administration, LLC, or our Administrator, employs our chief financial officer, chief compliance officer, internal counsel, treasurer, investor relations and their respective staffs.

Our Adviser and Administrator also provide investment advisory and administrative services, respectively, to our affiliates, Gladstone Capital Corporation and Gladstone Investment Corporation, both publicly-traded business development companies, as well as Gladstone Land Corporation, a private agricultural real estate company. With the exception of our chief financial officer, all of our executive officers serve as either directors or executive officers, or both, of Gladstone Capital Corporation and Gladstone Investment Corporation. In the future, our Adviser may provide investment advisory services to other funds, both public and private, of which it is the sponsor.

**Advisory and Administration Agreements**

We are externally managed pursuant to contractual arrangements with our Adviser and our Administrator. Our Adviser and Administrator employ all of our personnel and pay their payroll, benefits, and general expenses directly. We have an advisory agreement with our Adviser, or the Advisory Agreement, and an administration agreement with our Administrator, or the Administration Agreement.

Under the terms of the Advisory Agreement, we are responsible for all expenses incurred for our direct benefit. Examples of these expenses include legal, accounting, interest on short-term debt and mortgages, tax preparation, directors and officers insurance, stock transfer services, stockholder-related fees, consulting and related fees. In

addition, we are also responsible for all fees charged by third parties that are directly related to our business, which may include real estate brokerage fees, mortgage placement fees, lease-up fees and transaction structuring fees (although we may be able to pass some or all of such fees on to our tenants and borrowers).

During the years ended December 31, 2010, 2009 and 2008, none of these third party expenses were incurred by us directly. The actual amount of such fees that we incur in the future will depend largely upon the aggregate costs of the properties that we acquire, the aggregate amount of mortgage loans that we make

## **Table of Contents**

and the extent to which we are able to shift the burden of such fees to our tenants and borrowers. Accordingly, the amount of these fees that we will pay in the future is not determinable at this time.

### *Management Services and Fees under the Advisory Agreement*

The Advisory Agreement provides for an annual base management fee equal to 2.0% of our total stockholders' equity, less the recorded value of any preferred stock, or total common stockholders' equity, and for an incentive fee based on funds from operations, or FFO. Our Adviser does not charge acquisition or disposition fees when we acquire or dispose of properties as is common with other externally-advised REITs. Furthermore, there are no fees charged when our Adviser secures long or short term credit or arranges mortgage loans on our properties, however, our Adviser may earn fee income from our borrowers or tenants or other sources. This fee income earned by our Adviser, or a portion thereof, may, at the sole discretion of the Board of Directors, be credited against our base management fee as a rebate to the base management fee.

For purposes of calculating the incentive fee, FFO includes any realized capital gains and capital losses, less any distributions paid on preferred stock and senior common stock, but FFO does not include any unrealized capital gains or losses. The incentive fee would reward our Adviser if our quarterly FFO, before giving effect to any incentive fee, or pre-incentive fee FFO, exceeds 1.75%, or the hurdle rate, of total common stockholders' equity. We pay our Adviser an incentive fee with respect to our pre-incentive fee FFO in each calendar quarter as follows:

no incentive fee in any calendar quarter in which our pre-incentive fee FFO does not exceed the hurdle rate of 1.75% (7% annualized);

100% of the amount of the pre-incentive fee FFO that exceeds the hurdle rate, but is less than 2.1875% in any calendar quarter (8.75% annualized); and

20% of the amount of our pre-incentive fee FFO that exceeds 2.1875% in any calendar quarter (8.75% annualized).

### *Quarterly Incentive Fee Based on FFO*

Pre-incentive fee FFO

(expressed as a percentage of total common stockholders' equity)

Percentage of pre-incentive fee FFO allocated to incentive fee

The incentive fee may be reduced because of a covenant which exists in our line of credit agreement which limits distributions to our stockholders to 95% of FFO. In order to comply with this covenant, our board of directors accepted our Adviser's offer to unconditionally, irrevocably and voluntarily waive on a quarterly basis a portion of the incentive fee for the years ended December 31, 2010, 2009 and 2008, which allowed us to maintain the current level of distributions to our stockholders. These waived fees may not be recouped by our Adviser in the future. Our Adviser has indicated that it intends to continue to waive all or a portion of the incentive fee in order to support the current level of distributions to our stockholders; however, our Adviser is not required to issue any such waiver, either in whole or in part.

## **Table of Contents**

### *Administration Agreement*

Pursuant to the Administration Agreement, we pay for our allocable portion of our Administrator's overhead expenses incurred while performing its obligations to us, including, but not limited to, rent and the salaries and benefits expenses of our chief financial officer, chief compliance officer, internal counsel, treasurer, investor relations and their respective staffs. Our allocable portion of expenses is derived by multiplying our Administrator's total expenses by the percentage of our total assets at the beginning of each quarter in comparison to the total assets of all companies managed by our Adviser under similar agreements.

### **Critical Accounting Policies**

The preparation of our financial statements in accordance with generally accepted accounting principles in the United States of America, or GAAP, requires management to make judgments that are subjective in nature in order to make certain estimates and assumptions. Management relies on its experience, collects historical and current market data, and analyzes this information in order to arrive at what it believes to be reasonable estimates. Under different conditions or assumptions, materially different amounts could be reported related to the accounting policies described below. In addition, application of these accounting policies involves the exercise of judgment regarding the use of assumptions as to future uncertainties, and as a result, actual results could materially differ from these estimates. A summary of all of our significant accounting policies is provided in Note 1 to our consolidated financial statements included elsewhere in this Form 10-K. Below is a summary of accounting policies involving estimates and assumptions that require complex, subjective or significant judgments in their application and that materially affect our results of operations.

### *Allocation of Purchase Price*

When we acquire real estate, we allocate the purchase price, less any expenses related to the acquisition, to (i) the acquired tangible assets and liabilities, consisting of land, building, tenant improvements, long-term debt and (ii) the identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, the value of in-place leases, the value of unamortized lease origination costs, the value of tenant relationships and the value of capital lease obligations, based in each case on their fair values. All expenses related to the acquisition are expensed as incurred, rather than capitalized into the cost of the acquisition as had been required by the previous accounting. Management's estimates of value are made using methods similar to those used by independent appraisers (e.g., discounted cash flow analysis). Factors considered by management in its analysis include an estimate of carrying costs during hypothetical expected lease-up periods, considering current market conditions and costs to execute similar leases. We also consider information obtained about each property as a result of our pre-acquisition due diligence, marketing and leasing activities in estimating the fair value of the tangible and intangible assets and liabilities acquired. In estimating carrying costs, management also includes real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the hypothetical expected lease-up periods, which primarily range from 9 to 18 months, depending on specific local market conditions. Management also estimates costs to execute similar leases, including leasing commissions, legal and other related expenses to the extent that such costs are not already incurred in connection with a new lease origination as part of the transaction. Management also considers the nature and extent of our existing business relationships with the tenant, growth prospects for developing new business with the tenant, the tenant's credit quality and management's expectations of lease renewals (including those existing under the terms of the lease agreement), among other factors. A change in any of the assumptions above, which are very subjective, could have a material impact on our results of operations.

The allocation of the purchase price directly affects the following in our consolidated financial statements:

## **Table of Contents**

The amount of purchase price allocated to the various tangible and intangible assets on our balance sheet;

The amounts allocated to the value of above-market and below-market lease values are amortized to rental income over the remaining non-cancelable terms of the respective leases. The amounts allocated to all other tangible and intangible assets are amortized to depreciation or amortization expense. Thus, depending on the amounts allocated between land and other depreciable assets, changes in the purchase price allocation among our assets could have a material impact on our FFO, a metric which is used by many REIT investors to evaluate our operating performance; and

The period of time over which tangible and intangible assets are depreciated varies greatly, and thus, changes in the amounts allocated to these assets will have a direct impact on our results of operations. Intangible assets are generally amortized over the respective life of the leases, which normally range from 10 to 15 years. Also, we depreciate our buildings over 39 years, but do not depreciate our land. These differences in timing could have a material impact on our results of operations.

### *Asset Impairment Evaluation*

We periodically review the carrying value of each property to determine if circumstances that indicate impairment in the carrying value of the investment exist or that depreciation periods should be modified. In determining if impairment exists, management considers such factors as our tenants' payment history, the financial condition of our tenants, including calculating the current leverage ratios of tenants, the likelihood of lease renewal, business conditions in the industry in which our tenants operate and whether the carrying value of our real estate has decreased. If any of the factors above support the possibility of impairment, we prepare a projection of the undiscounted future cash flows, without interest charges, of the specific property and determine if the carrying amount in such property is recoverable. In preparing the projection of undiscounted future cash flows, we estimate the holding periods of the properties and cap rates using information that we obtain from market comparability studies and other comparable sources. If impairment is indicated, the carrying value of the property would be written down to its estimated fair value based on our best estimate of the property's discounted future cash flows using assumptions from market participants. Any material changes to the estimates and assumptions used in this analysis could have a significant impact on our results of operations, as the changes would impact our determination of whether impairment is deemed to have occurred and the amount of impairment loss that we would recognize.

Using the methodology discussed above and in light of the current economic conditions discussed above in

*Overview-Business Environment*, we evaluated our entire portfolio as of December 31, 2010 for any impairment indicators and performed an impairment analysis on those select properties that had an indication of impairment. Subsequent to this analysis, we concluded that none of our properties were impaired, and we will continue to monitor our portfolio for any indicators that may change our conclusion.

### *Provision for Loan Losses*

Our accounting policies require that we reflect in our financial statements an allowance for estimated credit losses with respect to mortgage loans that we have made based upon our evaluation of known and inherent risks associated with our private lending assets. Management reflects provisions for loan losses based upon our assessment of general market conditions, our internal risk management policies and credit risk rating system, industry loss experience, our assessment of the likelihood of delinquencies or defaults, and the value of the collateral underlying our investments. Any material changes to the estimates and assumptions used in this analysis could have a significant impact on our results of operations. We had no outstanding mortgage loans receivable as of December 31, 2010.

### *Recently Issued Accounting Pronouncements*

Refer to Note 1 in the accompanying consolidated financial statements for a summary of all recently issued accounting pronouncements.

**Table of Contents****Results of Operations**

Our weighted-average yield on our occupied portfolio as of December 31, 2010 was approximately 9.60%. The weighted-average yield on our occupied portfolio is calculated by taking the annualized straight-line rents, reflected as rental income on our consolidated statements of operations, or mortgage interest payments, reflected as interest income from mortgage notes receivable on our consolidated statements of operations, of each acquisition or mortgage loan as a percentage of the acquisition or loan price, as applicable. The weighted-average yield does not account for the interest expense incurred on the mortgages placed on our properties.

*A comparison of our operating results for the years ended December 31, 2010 and 2009 is below:*

|                                                     | 2010          | 2009          | \$ Change    | %<br>Change |
|-----------------------------------------------------|---------------|---------------|--------------|-------------|
| Operating revenues                                  |               |               |              |             |
| Rental income                                       | \$ 41,180,036 | \$ 41,513,977 | \$ (333,941) | -1%         |
| Interest income from mortgage note receivable       | 420,833       | 760,417       | (339,584)    | -45%        |
| Tenant recovery revenue                             | 327,201       | 334,543       | (7,342)      | -2%         |
| Total operating revenues                            | 41,928,070    | 42,608,937    | (680,867)    | -2%         |
| Operating expenses                                  |               |               |              |             |
| Depreciation and amortization                       | 13,263,814    | 13,161,287    | 102,527      | 1%          |
| Property operating expenses                         | 971,474       | 915,120       | 56,354       | 6%          |
| Due diligence expense                               | 411,776       | 40,574        | 371,202      | 100%        |
| Base management fee                                 | 1,198,717     | 1,401,402     | (202,685)    | -14%        |
| Incentive fee                                       | 3,480,061     | 3,238,634     | 241,427      | 7%          |
| Administration fee                                  | 1,063,091     | 1,015,695     | 47,396       | 5%          |
| Professional fees                                   | 2,570,522     | 649,566       | 1,920,956    | 100%        |
| Insurance expense                                   | 213,103       | 203,682       | 9,421        | 5%          |
| Directors' fees                                     | 196,735       | 198,882       | (2,147)      | -1%         |
| General and administrative                          | 427,948       | 442,135       | (14,187)     | -3%         |
| Total operating expenses before credit from Adviser | 23,797,241    | 21,266,977    | 2,530,264    | 12%         |
| Credit to base management fee                       | (225,000)     |               | (225,000)    | 100%        |
| Credit to incentive fee                             | (157,669)     | (726,448)     | 568,779      | -78%        |
| Total operating expenses                            | 23,414,572    | 20,540,529    | 2,874,043    | 14%         |
| Other income (expense)                              |               |               |              |             |
| Interest income from temporary investments          | 8,035         | 20,748        | (12,713)     | -61%        |
| Interest income employee loans                      | 150,882       | 192,350       | (41,468)     | -22%        |
| Other income                                        | 3,318,230     | 12,978        | 3,305,252    | 100%        |
| Interest expense                                    | (17,062,737)  | (17,894,536)  | 831,799      | -5%         |
| Total other expense                                 | (13,585,590)  | (17,668,460)  | 4,082,870    | -23%        |

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|                                               |             |             |            |       |
|-----------------------------------------------|-------------|-------------|------------|-------|
| Income from continuing operations             | 4,927,908   | 4,399,948   | 527,960    | 12%   |
| Discontinued operations                       |             |             |            |       |
| Income from discontinued operations           |             | 43,062      | (43,062)   | -100% |
| Gain on sale of real estate                   |             | 160,038     | (160,038)  | -100% |
| Total discontinued operations                 |             | 203,100     | (203,100)  | -100% |
| Net income                                    | 4,927,908   | 4,603,048   | 324,860    | 7%    |
| Distributions attributable to preferred stock | (4,093,750) | (4,093,750) |            | 0%    |
| Net income available to common stockholders   | \$ 814,108  | \$ 509,298  | \$ 304,810 | 60%   |

## **Table of Contents**

### *Operating Revenues*

Rental income remained relatively flat for the year ended December 31, 2010, as compared to the year ended December 31, 2009, as two of our tenants vacated their respective properties during 2010, slightly offset by the acquisition of a property in December 2010.

Interest income from mortgage notes receivable decreased for the year ended December 31, 2010, as compared to the year ended December 31, 2009, as our only mortgage loan was fully repaid in July 2010.

Tenant recovery revenue decreased slightly for the year ended December 31, 2010, as compared to the year ended December 31, 2009, because one of our tenants that vacated their property during 2010 no longer reimburses us for insurance expense.

### *Operating Expenses*

Depreciation and amortization expenses remained relatively flat for the year ended December 31, 2010, as compared to the year ended December 31, 2009, because we only acquired one property in December 2010, which had a minimal impact on the expense.

Property operating expenses consist of franchise taxes, management fees, insurance, ground lease payments and overhead expenses paid on behalf of certain of our properties. Property operating expenses increased during the year ended December 31, 2010, as compared to the year ended December 31, 2009, because of overhead, insurance and franchise tax expenses for which we are now responsible at the two properties where our leases expired and the tenants subsequently vacated during 2010.

Due diligence expenses primarily consist of legal fees and fees incurred for third-party reports prepared in connection with potential acquisitions and our due diligence analyses related thereto. Due diligence expenses increased for the year ended December 31, 2010, as compared to the year ended December 31, 2009, due to fees incurred in connection with the acquisition of the property in Orange City, Iowa in December 2010. Total due diligence expenses remain relatively low; however, with our adoption of Accounting Standards Codification, or ASC, 805 Business Combinations, on January 1, 2009, which requires that we no longer capitalize due diligence costs into the price of an acquisition, we expect that our due diligence expenses will increase significantly in 2011 as we intend to acquire more properties.

The base management fee decreased for the year ended December 31, 2010, as compared to the year ended December 31, 2009, due to a decrease in total common stockholders' equity, the main component of the calculation. Total common stockholders' equity decreased because distributions to common stockholders for the year ended December 31, 2010 exceeded net income during the period by approximately \$7.9 million. The calculation of the base management fee is described in detail above under *Advisory and Administration Agreements*.

The incentive fee increased for the year ended December 31, 2010, as compared to the year ended December 31, 2009, due to the increase in pre-incentive fee FFO caused by the \$3.3 million of additional income and prepayment fees we received in connection with the early repayment of our mortgage loan, coupled with the decrease in total common stockholders' equity. The calculation of the incentive fee is described in detail above under *Advisory and Administration Agreements*.

The administration fee increased for the year ended December 31, 2010, as compared to the year ended December 31, 2009, primarily as a result of an increase in the amount of the total expenses allocated from our Administrator during the periods. The calculation of the administration fee is described in detail above under *Advisory and Administration Agreements*.

Professional fees, consisting primarily of legal, consulting and accounting fees, increased during the year ended December 31, 2010, as compared to the year ended December 31, 2009, primarily due to the write-off of approximately \$1.6 million of fees and expenses incurred in relation to the private offering of unregistered senior common stock and related dividend reinvestment plan, discussed in *Overview - Recent*

**Table of Contents**

*Events-Equity Activities* above. In addition, we wrote-off approximately \$150,000 of fees incurred in connection with the filing of our base registration statement on Form S-3 with the SEC in 2007. These fees were written off in September 2010 when we filed a new base registration statement on Form S-3 with the SEC.

Insurance expense consists of the premiums paid for directors' and officers' insurance, which is renewed annually each September. Insurance expense increased for the year ended December 31, 2010, as compared to the year ended December 31, 2009, because of an increase in the premiums for the period from September 2009 through September 2010. Premiums for the period from September 2010 through September 2011 decreased by approximately 16%, thus we anticipate a decrease in insurance expenses in 2011.

Directors' fees remained relatively flat for the year ended December 31, 2010, as compared to the year ended December 31, 2009, as we made no changes to the compensation paid to our non-employee directors for 2010. General and administrative expenses decreased for the year ended December 31, 2010, as compared to the year ended December 31, 2009, primarily as a result of decreased costs associated with printing and filing our proxy materials and annual report in 2010.

*Other Income and Expense*

Interest income from temporary investments decreased during the year ended December 31, 2010, as compared to the year ended December 31, 2009, primarily because of lower interest rates earned on our money market accounts, coupled with interest received during 2009 from funds held on deposit for a prospective real estate acquisition. Interest income on employee loans decreased during the year ended December 31, 2010, as compared to the year ended December 31, 2009. This decrease was a result of loan payoffs made by employees during 2009 and 2010, coupled with other principal repayments during 2010.

Other income increased during the year ended December 31, 2010, as compared to the year ended December 31, 2009, because of the \$3.3 million in additional income and prepayment fees we received in connection with the early repayment of our mortgage loan in July 2010.

Interest expense decreased for the year ended December 31, 2010, as compared to the year ended December 31, 2009. This decrease was primarily a result of the approximately 2.3% decrease in the interest rate charged on our \$48.0 million mortgage loan that was renewed in September 2010, coupled with a decrease in the London Interbank Offered Rate, or LIBOR, from 2009, which reduced our interest expense under our line of credit and reduced interest expense on our long-term financings from amortizing principal payments made during 2009 and 2010.

*Discontinued Operations*

Income from discontinued operations for the year ended December 31, 2009 relates to the property that we sold in July 2009, which was located in Norfolk, Virginia.

**Table of Contents***Net Income Available to Common Stockholders*

Net income available to common stockholders increased for the year ended December 31, 2010, as compared to the year ended December 31, 2009 primarily because of the \$3.3 million in additional income and prepayment fees we received in connection with the early repayment of our mortgage loan in July 2010, partially offset by the write-off of \$1.6 million in fees related to the termination of our private offering of unregistered senior common stock.

*A comparison of our operating results for the years ended December 31, 2009 and 2008 is below:*

|                                                     | For the year ended December 31, |               |              | %      |
|-----------------------------------------------------|---------------------------------|---------------|--------------|--------|
|                                                     | 2009                            | 2008          | \$ Change    | Change |
| Operating revenues                                  |                                 |               |              |        |
| Rental income                                       | \$ 41,513,977                   | \$ 39,572,287 | \$ 1,941,690 | 5%     |
| Interest income from mortgage note receivable       | 760,417                         | 898,573       | (138,156)    | -15%   |
| Tenant recovery revenue                             | 334,543                         | 336,637       | (2,094)      | -1%    |
| Total operating revenues                            | 42,608,937                      | 40,807,497    | 1,801,440    | 4%     |
| Operating expenses                                  |                                 |               |              |        |
| Depreciation and amortization                       | 13,161,287                      | 12,679,437    | 481,850      | 4%     |
| Property operating expenses                         | 915,120                         | 875,850       | 39,270       | 4%     |
| Due diligence expense                               | 40,574                          | 1,176,379     | (1,135,805)  | -97%   |
| Base management fee                                 | 1,401,402                       | 1,637,851     | (236,449)    | -14%   |
| Incentive fee                                       | 3,238,634                       | 2,831,722     | 406,912      | 14%    |
| Administration fee                                  | 1,015,695                       | 954,635       | 61,060       | 6%     |
| Professional fees                                   | 649,566                         | 521,410       | 128,156      | 25%    |
| Insurance expense                                   | 203,682                         | 173,414       | 30,268       | 17%    |
| Directors' fees                                     | 198,882                         | 216,851       | (17,969)     | -8%    |
| General and administrative                          | 442,135                         | 493,119       | (50,984)     | -10%   |
| Total operating expenses before credit from Adviser | 21,266,977                      | 21,560,668    | (293,691)    | -1%    |
| Credit to incentive fee                             | (726,448)                       | (2,196,945)   | 1,470,497    | -67%   |
| Total operating expenses                            | 20,540,529                      | 19,363,723    | 1,176,806    | 6%     |
| Other income (expense)                              |                                 |               |              |        |
| Interest income from temporary investments          | 20,748                          | 21,844        | (1,096)      | -5%    |
| Interest income employee loans                      | 192,350                         | 202,097       | (9,747)      | -5%    |
| Other income                                        | 12,978                          | 63,993        | (51,015)     | -80%   |
| Interest expense                                    | (17,894,536)                    | (16,858,687)  | (1,035,849)  | 6%     |
| Total other expense                                 | (17,668,460)                    | (16,570,753)  | (1,097,707)  | 7%     |
| Income from continuing operations                   | 4,399,948                       | 4,873,021     | (473,073)    | -10%   |

|                                               |             |             |              |      |
|-----------------------------------------------|-------------|-------------|--------------|------|
| Discontinued operations                       |             |             |              |      |
| Income from discontinued operations           | 43,062      | 39,926      | 3,136        | 8%   |
| Gain on sale of real estate                   | 160,038     |             | 160,038      | 100% |
| Total discontinued operations                 | 203,100     | 39,926      | 163,174      | 409% |
| Net income                                    | 4,603,048   | 4,912,947   | (309,899)    | -6%  |
| Distributions attributable to preferred stock | (4,093,750) | (4,093,750) |              | 0%   |
| Net income available to common stockholders   | \$ 509,298  | \$ 819,197  | \$ (309,899) | -38% |

## **Table of Contents**

### *Operating Revenues*

Rental income increased for the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily as a result of the properties acquired during the year ended December 31, 2008 that were held for the full year in 2009.

Interest income from mortgage notes receivable decreased for the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily because interest income on our mortgage loan is based on LIBOR, which has significantly decreased over the past two years.

Tenant recovery revenue decreased slightly for the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily as a result of a decrease in the insurance premiums on some of our properties in which the tenants reimburse us for insurance expense, partially offset by an increase in the reimbursement of ground lease payments from a tenant.

### *Operating Expenses*

Depreciation and amortization expenses increased during the year ended December 31, 2009, as compared to the year ended December 31, 2008, as a result of the properties acquired during the year ended December 31, 2008 that were held for the full year in 2009.

Property operating expenses consist of franchise taxes, management fees, insurance, ground lease payments and overhead expenses paid on behalf of certain of our properties. Property operating expenses increased slightly during the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily because of an increase in ground lease payments coupled with repairs and maintenance performed at certain of our properties.

Due diligence expense primarily consists of legal fees and fees incurred for third-party reports prepared during our due diligence work. Due diligence expenses decreased significantly for the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily because of over \$1.0 million of fees incurred related to a large potential acquisition that did not close during 2008. However, with the adoption of ASC 805 Business Combinations, on January 1, 2009, discussed in detail in Note 1 of the accompanying consolidated financial statements, which requires us to no longer capitalize due diligence costs into the price of the acquisition, we expect our due diligence expense to increase significantly once we begin to acquire properties again.

The base management fee decreased for the year ended December 31, 2009, as compared to the year ended December 31, 2008, as a result of a decrease in total common stockholders' equity, the main component of the calculation. Total common stockholders' equity decreased because distributions to common stockholders for the year ended December 31, 2009 exceeded net income during the period by approximately \$8.2 million. The calculation of the base management fee is described in detail above under *Advisory and Administration Agreements*.

The incentive fee increased for the year ended December 31, 2009, as compared to the year ended December 31, 2008, due to the increase in pre-incentive fee FFO as a result of our increased rental income discussed above, coupled with the decrease in total common stockholders' equity. In addition, the amount that was credited to the incentive fee during the year ended December 31, 2009 decreased, because of an increase in operating income and a decrease in operating expenses. The calculation of the incentive fee is described in detail above under *Advisory and Administration Agreements*.

The administration fee increased for the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily as a result of an increase in our total assets in comparison to the total assets of all companies managed by our Adviser under similar agreements, coupled with approximately \$80,000 incurred by our Administrator, which was directly allocable to us, for the implementation of real estate software. The calculation of the administration fee is described in detail above under *Advisory and Administration Agreements*.

## **Table of Contents**

Professional fees, consisting primarily of legal and accounting fees, increased during the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily as a result of an increase in legal and other professional fees relating to ongoing lease renegotiations and reviews of our legal work with our existing tenants. Insurance expense consists of the premiums paid for directors' and officers' insurance, which is renewed annually each September. Insurance expense increased for the year ended December 31, 2009, as compared to the year ended December 31, 2008, because of an increase in the premiums for the periods from September 2008 through September 2009 and from September 2009 through September 2010.

Directors' fees decreased during the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily as a result of one of the independent directors becoming an interested director in January 2008, and thus not being paid an annual stipend during 2009.

General and administrative expenses decreased for the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily as a result of decreased costs associated with printing and filing our proxy materials.

### *Other Income and Expense*

Interest income from temporary investments decreased during the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily because of lower interest rates earned on our money market accounts, partially offset by interest received in 2009 from funds held on deposit for a prospective real estate acquisition, coupled with interest earned on amounts held in reserve accounts with our lenders.

Interest income on employee loans decreased during the year ended December 31, 2009, as compared to the year ended December 31, 2008. This decrease was a result of loan payoffs by employees during 2008 and 2009, coupled with other partial principal repayments over the periods.

Other income decreased during the year ended December 31, 2009, as compared to the year ended December 31, 2008, primarily because we no longer receive management fees from our tenant in our Burnsville, Minnesota property.

Interest expense increased for the year ended December 31, 2009, as compared to the year ended December 31, 2008. This was primarily a result of long-term financings, which closed during 2008, that were held for the full period during 2009.

### *Discontinued Operations*

Income from discontinued operations primarily relates to the property we sold, which was located in Norfolk, Virginia, including a gain on the sale of the property of approximately \$160,000. This is partially offset by continuing expenses related to the two Canadian properties, which we sold in July 2006. The expenses for the two Canadian properties relate to legal fees associated with the dissolution of the entities, which sold the properties.

### *Net Income Available to Common Stockholders*

Net income available to common stockholders decreased for the year ended December 31, 2009, as compared to the year ended December 31, 2008. This decrease was primarily a result of increased interest expense from the increased number of properties which have long-term financing partially offset by the gain on sale of our property in Norfolk, Virginia coupled with the growth of our portfolio of investments in the past year and the corresponding increase in our revenues and the other events described above.

## **Table of Contents**

### **Liquidity and Capital Resources**

#### *Future Capital Needs*

##### *Overview*

As of December 31, 2010, we had approximately \$7.0 million in cash and cash equivalents, had an available borrowing capacity of \$5.9 million under our New Line of Credit and had obtained mortgages on 56 of our properties. As of December 31, 2010, we had investments in 65 real properties having gross and net carrying values, including intangible assets, of approximately \$446.4 and \$384.1 million, respectively.

As discussed in *Overview Business Environment* above, although it improved during 2010, the U.S. economy generally, and the equity and debt capital markets specifically, continue to experience pervasive and fundamental disruptions. Because of these capital market conditions, our ability to issue equity securities, obtain additional mortgages and borrow debt proceeds, our three principal sources of external financing, was affected during 2010. Therefore, we primarily focused upon building the value of our existing portfolio of properties by renegotiating existing leases and making capital improvements to our properties.

##### *Equity Capital*

Despite the aforementioned economic conditions, the equity capital markets did improve in the latter half of 2010. As a result, we were able to raise approximately \$3.4 million pursuant to our Open Market Sales Agreement and approximately \$787,000 pursuant to our continuous private placement of unregistered senior common stock. In December 2010, we used a portion of these proceeds to finance the acquisition of our property that is located Orange City, Iowa and the remainder for general corporate and working capital needs. With the continued improvement of equity capital market conditions, we were able to raise approximately \$14.3 million of additional equity capital in February 2011. See *Overview Recent Events* above. We used these proceeds to repay a portion of the outstanding balance of the New Line of Credit and the remainder for general corporate and working capital needs.

Currently, we have the ability to raise up to approximately \$282.3 million of additional equity and debt capital through the sale of securities that are registered under our universal shelf registration statement on Form S-3 (the Universal Shelf ) in one or more future public offerings. Of the approximately \$282.3 million of available capacity under our Universal Shelf, approximately \$21.6 million of common stock is reserved for sale under our Open Market Sale Agreement.

##### *Debt Capital*

Despite the disruptions in the CMBS market discussed in *Overview Business Environment* above, we believe that banks are recommencing their general lending practices. Specifically, we are beginning to see banks that are willing to issue medium-term mortgages, between two and five years, on substantially less favorable terms than were previously available. Consequently, we will continue to focus on using medium-term mortgages to finance our real estate activities until the market for long-term mortgages returns. As of December 31, 2010, we had obtained approximately \$260.9 million in long-term financing which was secured by 56 of our properties. See *Mortgage Notes Payable* below for a more detailed discussion of our mortgage notes payable.

On April 15, 2005, we originated a mortgage loan in the amount of \$10.0 million that was collateralized by an office building located in McLean, Virginia in which our Adviser, and our Administrator, are subtenants. The mortgage loan was originally set to mature in May 2017, though, on July 22, 2010, it was fully repaid. We received \$3.3 million of additional income and prepayment fees in connection with the early payment and the proceeds were used to repay a portion of our Prior Line of Credit. In the future, we intend to expand our mortgage lending activity to by generating additional mortgage loans and purchasing mortgage loans from lenders, banks and CMBS pools. As of December 31, 2010, we had no mortgage loans outstanding.

## **Table of Contents**

In December 2010, we procured our New Line of Credit which provides for a senior secured revolving credit facility of up to \$50.0 million with a standby letter of credit sublimit of up to \$20.0 million. The New Line of Credit replaced our Prior Line of Credit which was scheduled to mature on December 29, 2010. Upon procuring the New Line of Credit, we repaid the \$29.8 million outstanding balance of the Prior Line of Credit with funds drawn from the New Line of Credit and with existing cash proceeds. We incurred no early termination penalties or fees in connection with the repayment of outstanding balance of the Prior Line of Credit. As of December 31, 2010, we had an outstanding principal balance of \$27.0 million under the New Line of Credit at an interest rate of approximately 3.3%, and we had remaining borrowing capacity of approximately \$5.9 million. See *Line of Credit* below for a more detailed discussion of our Prior Line of Credit and New Line of Credit.

### *Future Capital Needs*

We actively seek conservative investments that are likely to produce attractive long-term returns for our stockholders. If we are able to raise, procure or borrow additional equity and debt capital, we would intend to use the proceeds to continue to invest in industrial and commercial real property as well as expand our investment portfolio into other real property sectors, such as retail and medical properties, make mortgage loans, repurchase shares of our preferred stock on the open market or pay down outstanding borrowings under our New Line of Credit. Accordingly, to ensure that we are able to effectively execute our business strategy, we routinely review our liquidity requirements and continually evaluate all potential sources of liquidity. Our short-term liquidity needs include proceeds necessary to fund our distributions to stockholders, pay the debt services costs on our existing long-term mortgages, and fund our current operating costs. Our long-term liquidity needs include proceeds necessary to grow and maintain our portfolio of investments.

We believe that our current cash flows from operations, coupled with borrowings from our New Line of Credit, are sufficient to fund our distributions to stockholders, pay the debt service costs on our existing long-term mortgages and fund our current operating costs in the near term. We further believe that our cash flow from operations coupled with the potential financing capital available to us in the future are sufficient to fund our long-term liquidity needs. Additionally, to satisfy either our short-term or long-term obligations or both, we may require credits to our management fees that are issued from our Adviser although our Adviser is under no obligation to provide any such credits, either in whole or in part.

### *Operating Activities*

Net cash provided by operating activities during the year ended December 31, 2010 was approximately \$18.1 million, as compared to net cash provided by operating activities of approximately \$17.0 million for the year ended December 31, 2009. This increase was primarily a result of the additional income and prepayment fees that we received in connection with the early repayment of our mortgage loan in July 2010 coupled with reduced interest expense, partially offset by the increase in the net incentive fee, administration fee and property operating expenses. The majority of cash from operating activities is generated from the rental payments that we receive from our tenants. We utilize this cash to fund our property-level operating expenses and use the excess cash primarily for debt and interest payments on our mortgage notes payable, interest payments on our line of credit, distributions to our stockholders, management fees to our Adviser, and other entity-level expenses.

### *Investing Activities*

Net cash provided by investing activities during the year ended December 31, 2010 was approximately \$8.0 million, which primarily consisted of the repayment of our \$10.0 million mortgage loan, partially offset by the acquisition of our property located in Orange City, Iowa, net payments to our lenders for reserves and tenant improvements performed at certain of our properties, as compared to net cash used in investing activities during the year ended December 31, 2009 of approximately \$830,000, which primarily consisted of tenant improvements performed at our property located in Maple Heights, Ohio and net payments to lenders for reserves and leasing commissions paid related to the extension of the lease for our property

## **Table of Contents**

located in Eatontown, New Jersey, partially offset by proceeds from the sale of our property located in Norfolk, Virginia. We have had limited acquisition activity since 2008 because of the lack of access to capital as discussed in *Overview-Business Environment* above, which has resulted in a significant decrease in the cash used in investing activities.

### *Financing Activities*

Net cash used in financing activities for the year ended December 31, 2010 was approximately \$22.2 million, which primarily consisted of distributions paid to our stockholders, principal repayments on mortgage notes payable, payments for deferred financing costs and net repayments on our line of credit, partially offset by proceeds from sales of common and senior common stock. Net cash used in financing activities for the year ended December 31, 2009 was approximately \$17.6 million, which primarily consisted of repayment of our short-term loan, principal repayments on mortgage notes payable and distributions paid to our stockholders, partially offset by net borrowings from our line of credit.

### *Mortgage Notes Payable*

As of December 31, 2010, we had 17 fixed-rate mortgage notes payable in the aggregate principal amount of approximately \$260.9 million, collateralized by a total of 56 properties with terms at issuance ranging from 2 years to 25 years. The weighted-average interest rate on the mortgage notes payable as of December 31, 2010 was approximately 5.65%.

As discussed in *Overview-Recent Events* above, we had \$48.0 million of balloon principal payments maturing under one of our long-term mortgages in 2010; however, the mortgage has three annual extension options through 2013, and we exercised one of these options on September 30, 2010. In connection with the exercise of the option, the interest rate reset from 6.85% to 4.58% through September 30, 2011. At the time of notification of extension, we remitted a fee of 0.25% of the outstanding principal balance, or approximately \$120,000, and a certification to the lender that our aggregate debt service coverage ratio was not less than 1.2. The interest rate for the two additional extension periods will adjust based upon the 1-year swap rate at the time of extension and a fixed spread of 4.29% and 4.41%, respectively. We have no other balloon principal payments due under any of our mortgages until 2013.

### *Line of Credit*

In December 2010, we procured a new \$50.0 million line of credit, or the New Line of Credit, with Capital One, N.A. serving as a revolving lender, a letter of credit issuer and as an administrative agent and Branch Banking and Trust Company serving as a revolving lender and a letter of credit issuer, which matures on December 28, 2013. The New Line of Credit replaced our prior \$50.0 million senior secured revolving credit facility which was scheduled to mature on December 29, 2010, or the Prior Line of Credit. The New Line of Credit provides for a senior secured revolving credit facility of up to \$50.0 million, with a standby letter of credit sublimit of up to \$20.0 million. The New Line of Credit is subject to a maximum borrowing base calculation which may, from time to time, affect the maximum amount available to be drawn. The New Line of Credit may, upon satisfaction of certain conditions, be expanded up to \$75.0 million. Currently, eight of our properties are pledged as collateral under our line of credit. The interest rate per annum applicable to the New Line of Credit is equal to the London Interbank Offered Rate, or LIBOR, plus an applicable margin of up to 3.00% depending upon our leverage. Our leverage ratio used in determining the applicable margin for interest on the New Credit Line is recalculated quarterly. We will be subject to an annual maintenance fee of 0.25% per year. Our ability to access this source of financing is subject to our continued ability to meet customary lending requirements such as compliance with financial and operating covenants and our meeting certain lending limits. One such covenant requires us to limit distributions to our stockholders to 95% of our FFO, with acquisition-related costs required to be expensed under ASC 805 added back to FFO. In addition, the maximum amount that we may draw under this agreement is based on a percentage of the value of properties pledged as collateral to the banks, which must meet agreed upon eligibility standards. The maximum amount that we may currently draw under the New Line of Credit is approximately \$38.8 million. Furthermore, those eight properties that are pledged as collateral to the banks are pledged through a perfected first priority lien in the equity interest of the special

**Table of Contents**

purpose entity, or SPE, that owns the property. In addition, our Operating Partnership owns the SPEs, and our Operating Partnership is precluded from transferring the SPEs or unconsolidated affiliates to us.

If and when long-term mortgages are arranged for these pledged properties, the banks will release the properties from the line of credit and reduce the availability under the line of credit by the advanced amount of the released property. Conversely, as we purchase new properties meeting the eligibility standards, we may pledge these new properties to obtain additional advances under this agreement. The availability under the line of credit will also be reduced by letters of credit used in the ordinary course of business. We may use the advances under the line of credit for both general corporate purposes and the acquisition of new investments.

At December 31, 2010, there was \$27.0 million outstanding under the line of credit at an interest rate of approximately 3.3% and approximately \$5.9 million outstanding under letters of credit at a weighted average interest rate of approximately 3.0%. At December 31, 2010, the remaining borrowing capacity available under the line of credit was approximately \$5.9 million. Our ability to increase the availability under our line of credit is dependent upon our pledging additional properties as collateral. Traditionally, we have pledged new properties to the line of credit as we arrange for long-term mortgages for these pledged properties. Currently, only nine of our properties do not have long-term mortgages, and eight of those are pledged as collateral under our line of credit. Accordingly, we have only one property which is unencumbered, and which may be pledged as collateral to increase the borrowing capacity available under the line of credit. We were in compliance with all covenants under the New Line of Credit as of December 31, 2010.

**Table of Contents****Contractual Obligations**

The following table reflects our material contractual obligations as of December 31, 2010:

| Contractual Obligations                     | Total                 | Payments Due by Period |                      |                       |                       |
|---------------------------------------------|-----------------------|------------------------|----------------------|-----------------------|-----------------------|
|                                             |                       | Less than 1<br>Year    | 1-3 Years            | 3-5 Years             | More than 5<br>Years  |
| Debt Obligations <sup>(1)</sup>             | 287,869,463           | \$ 51,456,852          | \$ 43,408,839        | \$ 82,833,896         | \$ 110,169,876        |
| Interest on Debt Obligations <sup>(2)</sup> | 70,230,333            | 14,451,711             | 25,013,783           | 20,841,322            | 9,923,517             |
| Capital Lease Obligations <sup>(3)</sup>    | 300,000               |                        | 300,000              |                       |                       |
| Operating Lease Obligations <sup>(4)</sup>  | 1,601,357             | 152,510                | 305,020              | 305,020               | 838,807               |
| <b>Total</b>                                | <b>\$ 360,001,153</b> | <b>\$ 66,061,073</b>   | <b>\$ 69,027,642</b> | <b>\$ 103,980,238</b> | <b>\$ 120,932,200</b> |

- (1) Debt obligations represent borrowings under our line of credit, which represents \$27.0 million of the debt obligation due in 2013, and mortgage notes payable that were outstanding as of December 31, 2010.

The \$48.0 million mortgage note issued in September 2008 matures in October 2011, and we expect to exercise each of our options to extend the maturity date until October 2013. (2) Interest on debt obligations includes estimated interest on our borrowings under our line of credit. The balance and interest rate on our line of credit is variable; thus, the amount of interest calculated for purposes of this table was based upon rates and balances as of December 31, 2010. (3) Capital lease obligations represent the obligation to purchase the land held under the ground lease on our property located in Fridley, Minnesota. (4) Operating lease obligations represent the ground lease payments due on our Tulsa, Oklahoma property. The lease expires in June 2021.

**Off-Balance Sheet Arrangements**

We did not have any off-balance sheet arrangements as of December 31, 2010.

**Table of Contents****Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

Market risk includes risks that arise from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market sensitive instruments. The primary risk that we believe we are and will be exposed to is interest rate risk. Certain of our leases contain escalations based on market interest rates, and the interest rate on our existing line of credit is variable. Although we seek to mitigate this risk by structuring such provisions of our loans and leases to contain a minimum interest rate or escalation rate, as applicable, these features do not eliminate this risk. We have not entered into any derivative contracts to attempt to further manage our exposure to interest rate fluctuations.

To illustrate the potential impact of changes in interest rates on our net income for the year ended December 31, 2010, we have performed the following analysis, which assumes that our balance sheet remains constant and that no further actions beyond a minimum interest rate or escalation rate are taken to alter our existing interest rate sensitivity.

The following table summarizes the impact of a 1%, 2% and 3% increase in the one month LIBOR for the year ended December 31, 2010. As of December 31, 2010, our effective average LIBOR was 0.26%; thus, a 1% decrease could not occur.

| Interest Rate Change | Increase to<br>Rental<br>& Interest<br>Income | Increase to<br>Interest<br>Expense | Net Decrease<br>to<br>Net Income |
|----------------------|-----------------------------------------------|------------------------------------|----------------------------------|
| 1% Increase to LIBOR | \$                                            | \$ 279,000                         | \$ (279,000)                     |
| 2% Increase to LIBOR |                                               | 558,000                            | (558,000)                        |
| 3% Increase to LIBOR | 959                                           | 837,000                            | (836,041)                        |

As of December 31, 2010, the fair value of our fixed rate debt outstanding was approximately \$252.5 million. Interest rate fluctuations may affect the fair value of our fixed rate debt instruments. If interest rates on our fixed rate debt instruments, using rates at December 31, 2010, had been one percentage point higher or lower, the fair value of those debt instruments on that date would have decreased or increased by approximately \$9.2 million and \$9.8 million, respectively.

In the future, we may be exposed to additional effects of interest rate changes primarily as a result of our line of credit or long-term mortgage debt which we use to maintain liquidity and fund expansion of our real estate investment portfolio and operations. Our interest rate risk management objectives are to limit the impact of interest rate changes on earnings and cash flows and to lower overall borrowing costs. To achieve this objective, we will borrow primarily at fixed rates or variable rates with the lowest margins available and, in some cases, with the ability to convert variable rates to fixed rates. We may also enter into derivative financial instruments such as interest rate swaps and caps in order to mitigate the interest rate risk on a related financial instrument. We will not enter into derivative or interest rate transactions for speculative purposes.

In addition to changes in interest rates, the value of our real estate is subject to fluctuations based on changes in local and regional economic conditions and changes in the creditworthiness of lessees and borrowers, all of which may affect our ability to refinance debt if necessary.

**Table of Contents**

**Item 8. Financial Statements and Supplementary Data**

**Index to Consolidated Financial Statements**

Report of Management on Internal Controls over Financial Reporting

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2010 and December 31, 2009

Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008

Consolidated Statements of Stockholders' Equity for the years ended December 31, 2010, 2009 and 2008

Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008

Notes to Financial Statements

Schedule III Real Estate and Accumulated Depreciation

Schedule IV Mortgage Loans on Real Estate

64

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**Table of Contents**

**Report of Management on Internal Controls over Financial Reporting**

To the Stockholders and Board of Directors of Gladstone Commercial Corporation:

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is designed 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 and include those policies and procedures that pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and the dispositions of our assets, provide reasonable assurance that our transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with appropriate authorizations; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the supervision and with the participation of our management, we assessed the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations (COSO). Based on our assessment, management concluded that our internal control over financial reporting was effective as of December 31, 2010.

The effectiveness of our internal control over financial reporting as of December 31, 2010 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

March 8, 2011

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

To the Stockholders and Board of Directors of Gladstone Commercial Corporation:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Gladstone Commercial Corporation and its subsidiaries at December 31, 2010 and December 31, 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the accompanying index present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010 based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying report of Management's Annual Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedules, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

**Table of Contents**

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

McLean, VA

March 8, 2011

**Table of Contents****GLADSTONE COMMERCIAL CORPORATION  
CONSOLIDATED BALANCE SHEETS**

|                                | December 31,<br>2010  | December 31,<br>2009  |
|--------------------------------|-----------------------|-----------------------|
| <b>ASSETS</b>                  |                       |                       |
| Real estate, at cost           | \$ 401,016,940        | \$ 390,753,892        |
| Less: accumulated depreciation | 43,659,456            | 34,111,952            |
| Total real estate, net         | 357,357,484           | 356,641,940           |
| Lease intangibles, net         | 26,746,992            | 28,177,461            |
| Mortgage note receivable       |                       | 10,000,000            |
| Cash and cash equivalents      | 7,061,504             | 3,096,598             |
| Restricted cash                | 2,288,410             | 2,633,538             |
| Funds held in escrow           | 2,621,091             | 2,487,680             |
| Deferred rent receivable       | 10,373,508            | 8,975,196             |
| Deferred financing costs, net  | 3,325,740             | 3,136,055             |
| Other assets                   | 833,873               | 1,716,905             |
| <b>TOTAL ASSETS</b>            | <b>\$ 410,608,602</b> | <b>\$ 416,865,373</b> |

**LIABILITIES AND STOCKHOLDERS EQUITY**

|                                       |                    |                    |
|---------------------------------------|--------------------|--------------------|
| <b>LIABILITIES</b>                    |                    |                    |
| Mortgage notes payable                | \$ 260,869,463     | \$ 252,761,651     |
| Borrowings under line of credit       | 27,000,000         | 33,200,000         |
| Deferred rent liability               | 2,276,033          | 3,213,195          |
| Asset retirement obligation liability | 3,062,768          | 2,305,644          |
| Accounts payable and accrued expenses | 2,682,915          | 2,086,741          |
| Due to Adviser <sup>(1)</sup>         | 965,373            | 1,213,640          |
| Other liabilities                     | 2,377,743          | 3,633,960          |
| <b>Total Liabilities</b>              | <b>299,234,295</b> | <b>298,414,831</b> |

**STOCKHOLDERS EQUITY**

|                                                                                                                                                                                                 |       |       |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|-------|
| Redeemable preferred stock, \$0.001 par value; \$25 liquidation preference; 2,300,000 shares authorized and 2,150,000 shares issued and outstanding at December 31, 2010 and 2009, respectively | 2,150 | 2,150 |
| Senior common stock, \$0.001 par value; 7,500,000 shares authorized and 59,057 and 0 shares issued and outstanding at December 31, 2010 and 2009, respectively                                  | 59    |       |
| Common stock, \$0.001 par value, 40,200,000 shares authorized and 8,724,613 and 8,563,264 shares issued and outstanding at December 31, 2010 and 2009, respectively                             | 8,725 | 8,563 |

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|                                                 |                |                |
|-------------------------------------------------|----------------|----------------|
| Additional paid in capital                      | 174,260,531    | 170,622,581    |
| Notes receivable employees                      | (963,433)      | (2,304,999)    |
| Distributions in excess of accumulated earnings | (61,933,725)   | (49,877,753)   |
| Total Stockholders Equity                       | 111,374,307    | 118,450,542    |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY       | \$ 410,608,602 | \$ 416,865,373 |

(1) Refer to Note 2 *Related-Party Transactions*

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents**

**GLADSTONE COMMERCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

|                                                      | For the year ended December 31, |               |               |
|------------------------------------------------------|---------------------------------|---------------|---------------|
|                                                      | 2010                            | 2009          | 2008          |
| Operating revenues                                   |                                 |               |               |
| Rental income                                        | \$ 41,180,036                   | \$ 41,513,977 | \$ 39,572,287 |
| Interest income from mortgage note receivable        | 420,833                         | 760,417       | 898,573       |
| Tenant recovery revenue                              | 327,201                         | 334,543       | 336,637       |
| Total operating revenues                             | 41,928,070                      | 42,608,937    | 40,807,497    |
| Operating expenses                                   |                                 |               |               |
| Depreciation and amortization                        | 13,263,814                      | 13,161,287    | 12,679,437    |
| Property operating expenses                          | 971,474                         | 915,120       | 875,850       |
| Due diligence expense                                | 411,776                         | 40,574        | 1,176,379     |
| Base management fee <sup>(1)</sup>                   | 1,198,717                       | 1,401,402     | 1,637,851     |
| Incentive fee <sup>(1)</sup>                         | 3,480,061                       | 3,238,634     | 2,831,722     |
| Administration fee <sup>(1)</sup>                    | 1,063,091                       | 1,015,695     | 954,635       |
| Professional fees                                    | 2,570,522                       | 649,566       | 521,410       |
| Insurance expense                                    | 213,103                         | 203,682       | 173,414       |
| Directors' fees                                      | 196,735                         | 198,882       | 216,851       |
| General and administrative                           | 427,948                         | 442,135       | 493,119       |
| Total operating expenses before credits from Adviser | 23,797,241                      | 21,266,977    | 21,560,668    |
| Credit to base management fee                        | (225,000)                       |               |               |
| Credit to incentive fee                              | (157,669)                       | (726,448)     | (2,196,945)   |
| Total operating expenses                             | 23,414,572                      | 20,540,529    | 19,363,723    |
| Other income (expense)                               |                                 |               |               |
| Interest income from temporary investments           | 8,035                           | 20,748        | 21,844        |
| Interest income - employee loans                     | 150,882                         | 192,350       | 202,097       |
| Other income                                         | 3,318,230                       | 12,978        | 63,993        |
| Interest expense                                     | (17,062,737)                    | (17,894,536)  | (16,858,687)  |
| Total other expense                                  | (13,585,590)                    | (17,668,460)  | (16,570,753)  |
| Income from continuing operations                    | 4,927,908                       | 4,399,948     | 4,873,021     |
| Discontinued operations                              |                                 |               |               |
| Income from discontinued operations                  |                                 | 43,062        | 39,926        |
| Gain on sale of real estate                          |                                 | 160,038       |               |

|                                                                                          |             |             |             |
|------------------------------------------------------------------------------------------|-------------|-------------|-------------|
| Total discontinued operations                                                            |             | 203,100     | 39,926      |
| Net income                                                                               | 4,927,908   | 4,603,048   | 4,912,947   |
| Distributions attributable to preferred stock                                            | (4,093,750) | (4,093,750) | (4,093,750) |
| Distributions attributable to senior common stock                                        | (20,050)    |             |             |
| Net income available to common stockholders                                              | \$ 814,108  | \$ 509,298  | \$ 819,197  |
| Earnings per weighted average share of common stock basic                                |             |             |             |
| Income from continuing operations (net of distributions attributable to preferred stock) | \$ 0.09     | \$ 0.04     | \$ 0.09     |
| Discontinued operations                                                                  |             | 0.02        | 0.01        |
| Net income available to common stockholders                                              | \$ 0.09     | \$ 0.06     | \$ 0.10     |
| Earnings per weighted average share of common stock diluted                              |             |             |             |
| Income from continuing operations (net of dividends attributable to preferred stock)     | \$ 0.09     | \$ 0.04     | \$ 0.09     |
| Discontinued operations                                                                  |             | 0.02        | 0.01        |
| Net income available to common stockholders                                              | \$ 0.09     | \$ 0.06     | \$ 0.10     |
| Weighted average shares of common stock outstanding basic                                | 8,576,303   | 8,563,264   | 8,565,149   |
| Weighted average shares of common stock outstanding diluted                              | 8,601,153   | 8,563,264   | 8,565,149   |
| Earnings per weighted average share of senior common stock                               | \$ 0.81     | \$          | \$          |
| Weighted average shares of senior common stock outstanding basic                         | 24,850      | 0           | 0           |

(1) Refer to Note 2 *Related-Party Transactions*

The accompanying notes are an integral part of these consolidated financial statements.



**Table of Contents**

**GLADSTONE COMMERCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

|                                                             | Preferred Stock | Senior Common Stock | Common Stock | Capital in Excess of Par Value | Notes Receivable from Employees | Distributions in Excess of Accumulated Earnings | Total Stockholders' Equity |
|-------------------------------------------------------------|-----------------|---------------------|--------------|--------------------------------|---------------------------------|-------------------------------------------------|----------------------------|
| Balance at December 31, 2007                                | \$ 2,150        |                     | \$ 8,565     | \$ 170,640,979                 | \$ (2,769,923)                  | \$ (25,513,703)                                 | \$ 142,368,068             |
| Forfeiture of Common Stock                                  |                 |                     | (2)          | (18,398)                       |                                 |                                                 | (18,400)                   |
| Repayment of Principal on Notes Receivable                  |                 |                     |              |                                | 174,037                         |                                                 | 174,037                    |
| Distributions Declared to Common and Preferred Stockholders |                 |                     |              |                                |                                 | (16,941,392)                                    | (16,941,392)               |
| Net income                                                  |                 |                     |              |                                |                                 | 4,912,947                                       | 4,912,947                  |
| Balance at December 31, 2008                                | \$ 2,150        | \$                  | \$ 8,563     | \$ 170,622,581                 | \$ (2,595,886)                  | \$ (37,542,148)                                 | \$ 130,495,260             |
| Repayment of Principal on Notes Receivable                  |                 |                     |              |                                | 45,887                          |                                                 | 45,887                     |
| Reclassification of Loan Balance to Other Assets            |                 |                     |              |                                | 245,000                         |                                                 | 245,000                    |
| Distributions Declared to Common and Preferred Stockholders |                 |                     |              |                                |                                 | (16,938,653)                                    | (16,938,653)               |

|                                                                                                   |          |       |          |                |                |                 |                |
|---------------------------------------------------------------------------------------------------|----------|-------|----------|----------------|----------------|-----------------|----------------|
| Net income                                                                                        |          |       |          |                |                | 4,603,048       | 4,603,048      |
| Balance at<br>December 31,<br>2009                                                                | \$ 2,150 | \$    | \$ 8,563 | \$ 170,622,581 | \$ (2,304,999) | \$ (49,877,753) | \$ 118,450,542 |
| Issuance of senior<br>common stock<br>and common<br>stock                                         |          | 59    | 180      | 3,881,832      |                |                 | 3,882,071      |
| Repayment of<br>principal on notes<br>receivable                                                  |          |       |          |                | 1,341,566      |                 | 1,341,566      |
| Distributions<br>declared to<br>common, senior<br>common and<br>preferred<br>stockholders         |          |       |          |                |                | (16,983,880)    | (16,983,880)   |
| Forfeiture of<br>common stock in<br>satisfaction of<br>employee note<br>receivable <sup>(1)</sup> |          |       | (18)     | (243,882)      |                |                 | (243,900)      |
| Net income                                                                                        |          |       |          |                |                | 4,927,908       | 4,927,908      |
| Balance at<br>December 31,<br>2010                                                                | \$ 2,150 | \$ 59 | \$ 8,725 | \$ 174,260,531 | \$ (963,433)   | \$ (61,933,725) | \$ 111,374,307 |

- (1) On February 1, 2010, the maturity date of an employee stock option loan to a former employee of the Adviser was extended until August 2010. In connection with the extension of the loan, the recourse provision of the loan was removed, and the former employee was granted the option to either repay the principal and interest in full or return the 18,000 shares pledged against the loan to the Company in full satisfaction of the loan. On March 8, 2010, the date that the market price of the pledged shares equaled the balance of the outstanding loan, the pledged shares were returned to the Company, and the loan was deemed paid in full.

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents**

**GLADSTONE COMMERCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

|                                                                                   | For the year ended December 31, |              |              |
|-----------------------------------------------------------------------------------|---------------------------------|--------------|--------------|
|                                                                                   | 2010                            | 2009         | 2008         |
| Cash flows from operating activities:                                             |                                 |              |              |
| Net income                                                                        | \$ 4,927,908                    | \$ 4,603,048 | \$ 4,912,947 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |              |              |
| Depreciation and amortization, including discontinued operations                  | 13,263,814                      | 13,171,703   | 12,704,641   |
| Amortization of deferred financing costs                                          | 1,002,428                       | 1,491,389    | 1,283,956    |
| Amortization of deferred rent asset and liability, net                            | (683,666)                       | (532,068)    | (532,066)    |
| Amortization of discount on assumed debt                                          | 11,301                          |              |              |
| Asset retirement obligation expense, including discontinued operations            | 143,060                         | 143,550      | 133,244      |
| Gain on sale of real estate                                                       |                                 | (160,038)    |              |
| Decrease (increase) in other assets                                               | 389,133                         | (959,738)    | 172,096      |
| Increase in deferred rent receivable                                              | (1,651,809)                     | (1,177,167)  | (2,387,509)  |
| Increase in accounts payable, accrued expenses, and amount due Adviser            | 347,908                         | 735,492      | 1,001,639    |
| Increase (decrease) in other liabilities                                          | 363,366                         | (302,914)    | 286,227      |
| Net cash provided by operating activities                                         | 18,113,443                      | 17,013,257   | 17,575,175   |
| Cash flows from investing activities:                                             |                                 |              |              |
| Real estate investments                                                           | (2,418,534)                     | (1,139,711)  | (49,359,852) |
| Leasing commissions paid                                                          | (7,044)                         | (441,745)    |              |
| Proceeds from sale of real estate                                                 |                                 | 1,089,269    |              |
| Principal repayments on mortgage notes receivable                                 | 10,000,000                      |              |              |
| Receipts from lenders for reserves held in escrow                                 | 1,617,933                       | 1,465,133    | 874,227      |
| Payments to lenders for reserves held in escrow                                   | (1,751,344)                     | (1,801,894)  | (1,623,452)  |
| Decrease (increase) in restricted cash                                            | 345,128                         | 44,023       | (763,494)    |
| Deposits on future acquisitions                                                   |                                 | (250,000)    | (1,650,000)  |
| Deposits refunded                                                                 | 250,000                         | 200,000      | 1,750,000    |
| Net cash provided by (used in) investing activities                               | 8,036,139                       | (834,925)    | (50,772,571) |
| Cash flows from financing activities:                                             |                                 |              |              |
| Proceeds from issuance of common and senior common stock                          | 4,126,690                       |              |              |
| Offering costs                                                                    | (248,829)                       |              |              |
| Borrowings under mortgage notes payable                                           |                                 |              | 48,015,000   |
| Principal repayments on mortgage notes payable                                    | (2,687,192)                     | (2,349,522)  | (1,485,901)  |
| Principal repayments on employee notes receivable                                 | 1,341,566                       | 290,887      | 155,637      |
| Borrowings from line of credit                                                    | 32,794,746                      | 57,600,000   | 76,900,000   |
| Repayments on line of credit                                                      | (38,994,746)                    | (35,900,000) | (69,800,000) |

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|                                                                        |               |               |               |
|------------------------------------------------------------------------|---------------|---------------|---------------|
| Repayment of short-term loan                                           |               | (20,000,000)  |               |
| Receipts from tenants for reserves                                     | 2,154,699     | 4,454,102     | 2,391,360     |
| Payments to tenants from reserves                                      | (2,130,232)   | (4,526,409)   | (2,159,671)   |
| (Decrease) increase in security deposits                               | (369,595)     | 28,282        | 531,806       |
| Payments for deferred financing costs                                  | (1,192,113)   | (243,999)     | (1,262,273)   |
| Distributions paid for common and preferred                            | (16,979,670)  | (16,938,653)  | (16,941,392)  |
| Net cash (used in) provided by financing activities                    | (22,184,676)  | (17,585,312)  | 36,344,566    |
| Net increase (decrease) in cash and cash equivalents                   | 3,964,906     | (1,406,980)   | 3,147,170     |
| Cash and cash equivalents, beginning of year                           | 3,096,598     | 4,503,578     | 1,356,408     |
| Cash and cash equivalents, end of year                                 | \$ 7,061,504  | \$ 3,096,598  | \$ 4,503,578  |
| Cash paid during period for interest                                   | \$ 17,969,864 | \$ 16,558,955 | \$ 14,337,944 |
| NON-CASH OPERATING, INVESTING AND FINANCING INFORMATION                |               |               |               |
| Increase in asset retirement obligation                                | \$ 614,064    | \$            | \$ 245,196    |
| Fixed rate debt assumed in connection with acquisitions                | \$ 10,795,004 | \$            | \$ 6,461,603  |
| Obligation under capital lease                                         | \$            | \$            | \$ 225,068    |
| Forfeiture of common stock in satisfaction of employee note receivable | \$ 243,900    | \$            | \$ 18,400     |
| Senior common dividend issued in the dividend reinvestment program     | \$ 4,210      | \$            | \$            |
| Reclassification of principal on employee note (Refer to Note 8)       | \$            | \$ 245,000    | \$            |
| Leasing commissions included in accounts payable                       | \$ 457,939    | \$            | \$            |

The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents**

**GLADSTONE COMMERCIAL CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Organization and Significant Accounting Policies**

Gladstone Commercial Corporation (the Company) was incorporated on February 14, 2003 under the General Corporation Law of Maryland. The Company operates in a manner so as to qualify as a real estate investment trust (REIT) for federal income tax purposes and exists primarily for the purposes of engaging in the business of investing in real estate properties net leased to creditworthy entities and making mortgage loans to creditworthy entities. Subject to certain restrictions and limitations, the business of the Company is managed by Gladstone Management Corporation, a Delaware corporation (the Adviser).

***Subsidiaries***

The Company conducts substantially all of its operations through a subsidiary, Gladstone Commercial Limited Partnership, a Delaware limited partnership (the Operating Partnership). As the Company currently owns all of the general and limited partnership interests of the Operating Partnership through GCLP Business Trust I and II, as discussed in more detail below, the financial position and results of operations of the Operating Partnership are consolidated with those of the Company.

Gladstone Commercial Lending, LLC, a Delaware limited liability company (Gladstone Commercial Lending) and a subsidiary of the Company, was created to conduct all operations related to real estate mortgage loans of the Company. As the Operating Partnership currently owns all of the membership interests of Gladstone Commercial Lending, the financial position and results of operations of Gladstone Commercial Lending are consolidated with those of the Company.

Gladstone Commercial Advisers, Inc., a Delaware corporation (Commercial Advisers) and a subsidiary of the Company, is a taxable REIT subsidiary (TRS), which was created to collect all non-qualifying income related to the Company's real estate portfolio. It is currently anticipated that this income will predominately consist of fees received by the Company related to the leasing of real estate. There have been no such fees earned to date. Since the Company owns 100% of the voting securities of Commercial Advisers, the financial position and results of operations of Commercial Advisers are consolidated with those of the Company.

GCLP Business Trust I and GCLP Business Trust II, each a subsidiary and business trust of the Company, were formed under the laws of the Commonwealth of Massachusetts on December 28, 2005. The Company transferred its 99% limited partnership interest in the Operating Partnership to GCLP Business Trust I in exchange for 100 trust shares. Commercial Partners transferred its 1% general partnership interest in the Operating Partnership to GCLP Business Trust II in exchange for 100 trust shares.

***Investments in Real Estate***

The Company records investments in real estate at cost and capitalizes improvements and replacements when they extend the useful life or improve the efficiency of the asset. The Company expenses costs of repairs and maintenance as such costs are incurred. The Company computes depreciation using the straight-line method over the estimated useful life or 39 years for buildings and improvements, 5 to 7 years for equipment and fixtures and the shorter of the useful life or the remaining lease term for tenant improvements and leasehold interests.

The Company accounts for its acquisitions of real estate in accordance with Accounting Standards Codification (ASC) 805, Business Combinations, which requires that the purchase price of real estate be recorded at fair value and allocated to the acquired tangible assets and liabilities, consisting of land, building, tenant improvements, long-term debt and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, the value of in-place leases, the value of unamortized lease origination costs, the value of tenant relationships and the value of capital lease obligations, based in

**Table of Contents**

each case on their fair values. ASC 805 also requires that all expenses related to the acquisition be expensed as incurred, rather than capitalized into the cost of the acquisition as had been the previous accounting.

Management's estimates of value are made using methods similar to those used by independent appraisers (e.g., discounted cash flow analysis). Factors considered by Management in its analysis include an estimate of carrying costs during hypothetical expected lease-up periods considering current market conditions and costs to execute similar leases. The Company also considers information obtained about each property as a result of its pre-acquisition due diligence, marketing and leasing activities in estimating the fair value of the tangible and intangible assets and liabilities acquired. In estimating carrying costs, Management also includes real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the hypothetical expected lease-up periods, which primarily range from nine to eighteen months, depending on specific local market conditions. Management also estimates costs to execute similar leases, including leasing commissions, legal and other related expenses to the extent that such costs are not already incurred in connection with a new lease origination as part of the transaction.

The Company allocates purchase price to the fair value of the tangible assets of an acquired property by valuing the property as if it were vacant. The as-if-vacant value is allocated to land, building, and tenant improvements based on Management's determination of the relative fair values of these assets. Real estate depreciation expense on these tangible assets, including discontinued operations, was approximately \$9.5 million, \$9.4 million and \$9.0 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Above-market and below-market in-place lease values for owned properties are recorded based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) Management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. The capitalized above-market lease values, included in the accompanying balance sheet as part of deferred rent receivable, are amortized as a reduction of rental income over the remaining non-cancelable terms of the respective leases. Total amortization related to above-market lease values was approximately \$253,000 for each of the years ended December 31, 2010, 2009 and 2008, respectively. The capitalized below-market lease values, included in the accompanying consolidated balance sheet as deferred rent liability, are amortized as an increase to rental income over the remaining non-cancelable terms of the respective leases. Total amortization related to below-market lease values was approximately \$937,000 for the year ended December 31, 2010, and \$786,000 for each of the years ending December 31, 2009 and 2008.

The total amount of the remaining intangible assets acquired, which consist of in-place lease values, unamortized lease origination costs, and customer relationship intangible values, are allocated based on Management's evaluation of the specific characteristics of each tenant's lease and the Company's overall relationship with that respective tenant. Characteristics to be considered by Management in allocating these values include the nature and extent of our existing business relationships with the tenant, growth prospects for developing new business with the tenant, the tenant's credit quality and the Company's expectations of lease renewals (including those existing under the terms of the lease agreement), among other factors.

The value of in-place leases and unamortized lease origination costs are amortized to expense over the remaining term of the respective leases, which generally range from 10 to 15 years. The value of customer relationship intangibles, which is the benefit to the Company resulting from the likelihood of an existing tenant renewing its lease, are amortized to expense over the remaining term and any anticipated renewal periods in the respective leases, but in no event does the amortization period for intangible assets exceed the remaining depreciable life of the building. Should a tenant terminate its lease, the unamortized portion of the above-market and below-market lease values, in-place lease values, unamortized lease origination costs and customer relationship intangibles will be immediately charged to the related income or expense. Total amortization expense related to these intangible assets, including discontinued operations, was approximately \$3.7 million for each of the years ended December 31, 2010, 2009 and 2008, respectively.

## **Table of Contents**

### ***Impairment***

#### ***Investments in Real Estate***

The Company accounts for the impairment of real estate, including intangible assets, in accordance with ASC 360-10-35, Property, Plant, and Equipment, which requires the Company to periodically review the carrying value of each property to determine if circumstances indicate impairment in the carrying value of the investment exist or that depreciation periods should be modified. If circumstances support the possibility of impairment, the Company prepares a projection of the undiscounted future cash flows, without interest charges, of the specific property and determines if the investment in such property is recoverable. If impairment is indicated, the carrying value of the property would be written down to its estimated fair value based on the Company's best estimate of the property's discounted future cash flows. There have been no impairments recognized on real estate assets in the Company's history.

In light of current economic conditions, the Company evaluated its entire portfolio as of December 31, 2010 for any impairment indicators and performed an impairment analysis on those select properties that had an indication of impairment. In performing the analysis, the Company considered such factors as the tenants' payment history and financial condition, the likelihood of lease renewal, business conditions in the industry in which the tenants operate and whether the fair value of the real estate has decreased. The Company concluded that none of its properties were impaired, and will continue to monitor its portfolio for any indicators that may change this conclusion.

#### ***Provision for Loan Losses***

The Company's accounting policies require it to reflect in its financial statements an allowance for estimated credit losses with respect to mortgage loans receivable that it has made based upon its evaluation of known and inherent risks associated with its private lending assets. Management reflects provisions for loan losses based upon its assessment of general market conditions, its internal risk management policies and credit risk rating system, industry loss experience, its assessment of the likelihood of delinquencies or defaults, and the value of the collateral underlying its investments. Actual losses, if any, could ultimately differ from these estimates. There have been no provisions for loan losses in the Company's history and the Company currently has no outstanding mortgage loans receivable.

### ***Cash and Cash Equivalents***

The Company considers cash equivalents to be all short-term, highly-liquid investments that are both readily convertible to cash and have a maturity of three months or less at the time of purchase, except that any such investments purchased with funds held in escrow or similar accounts are classified as restricted cash. Items classified as cash equivalents include money-market deposit accounts. All of the Company's cash and cash equivalents at December 31, 2010 were held in the custody of two financial institutions, and the Company's balance at times may exceed federally insurable limits.

### ***Restricted Cash***

Restricted cash consists of security deposits and funds held in escrow for certain tenants. These funds will be released to the tenants upon completion of agreed upon tasks, as specified in the lease agreements, mainly consisting of maintenance and repairs on the buildings and upon receipt by the Company of evidence of insurance and tax payments.

### ***Funds Held in Escrow***

Funds held in escrow consist of funds held by certain of the Company's lenders for properties held as collateral by these lenders. These funds will be released to the Company upon completion of agreed upon tasks as specified in the mortgage agreements, mainly consisting of maintenance and repairs on the buildings, and when evidence of insurance and tax payments has been submitted to the lenders.

**Table of Contents**

***Deferred Financing Costs***

Deferred financing costs consist of costs incurred to obtain financing, including legal fees, origination fees and administrative fees. The costs are deferred and amortized using the straight-line method, which approximates the effective interest method over the term of the secured financing. The Company made payments of approximately \$1.2 million, \$244,000 and \$1.3 million for deferred financing costs during the years ended December 31, 2010, 2009 and 2008, respectively. Total amortization expense related to deferred financing costs was approximately \$1.0 million, \$1.5 million and \$1.3 million for the years ended December 31, 2010, 2009 and 2008, respectively.

***Obligation Under Capital Lease***

In conjunction with the Company's acquisition of a building in Fridley, Minnesota in February 2008, the Company acquired a ground lease on the parking lot of the building, which had a purchase obligation to acquire the land under the ground lease at the end of the term in April 2014 for \$300,000. In accordance with ASC 840-10-25, Leases, the Company accounted for the ground lease as a capital lease and recorded the corresponding present value of the obligation under the capital lease. The Company recorded total interest expense related to the accretion of the capital lease obligation of approximately \$12,000, \$12,000 and \$10,000 for the years ended December 31, 2010, 2009 and 2008, respectively.

***Revenue Recognition***

Rental revenue includes rents that each tenant pays in accordance with the terms of its respective lease reported evenly over the non-cancelable term of the lease. Most of the Company's leases contain rental increases at specified intervals. The Company recognizes such revenues on a straight-line basis by averaging the non-cancelable rental revenues over the lease terms. Deferred rent receivable in the accompanying consolidated balance sheet includes the cumulative difference between rental revenue as recorded on a straight line basis and rents received from the tenants in accordance with the lease terms, along with the capitalized above-market lease values of certain acquired properties. Accordingly, the Company determines, in its judgment, to what extent the deferred rent receivable applicable to each specific tenant is collectable. The Company reviews deferred rent receivable, as it relates to straight line rents, on a quarterly basis and takes into consideration the tenant's payment history, the financial condition of the tenant, business conditions in the industry in which the tenant operates and economic conditions in the geographic area in which the property is located. In the event that the collectability of deferred rent with respect to any given tenant is in doubt, the Company records an allowance for uncollectable accounts or records a direct write-off of the specific rent receivable. No such reserves have been recorded as of December 31, 2010.

Management considers its loans and other lending investments to be held-for-investment. The Company reflects loans classified as long-term investments at amortized cost, less allowance for loan losses, acquisition premiums or discounts, and deferred loan fees. On occasion, the Company may acquire loans at small premiums or discounts based on the credit characteristics of such loans. These premiums or discounts are recognized as yield adjustments over the lives of the related loans. Loan origination fees, as well as direct loan origination costs, are also deferred and recognized over the lives of the related loans as yield adjustments. If loans with premiums, discounts, or loan origination fees are prepaid, the Company immediately recognizes the unamortized portion as a decrease or increase in the prepayment gain or loss. Interest income is recognized using the effective interest method applied on a loan-by-loan basis. Prepayment penalties or yield maintenance payments from borrowers are recognized as additional income when received.

Tenant recovery revenue includes payments from tenants as reimbursements for franchises taxes, management fees, insurance, and ground lease payments. The Company recognizes tenant recovery revenue in the same periods that it incurs the related expenses.

## **Table of Contents**

### ***Income Taxes***

The Company has operated and intends to continue to operate in a manner that will allow it to qualify as a REIT under the Internal Revenue Code of 1986, as amended, and, accordingly, will not be subject to federal income taxes on amounts distributed to stockholders (except income from foreclosure property), provided that it distributes at least 90% of its REIT taxable income to its stockholders and meets certain other conditions. To the extent that the Company satisfies the distribution requirement but distributes less than 100% of its taxable income, the Company will be subject to federal corporate income tax on its undistributed income.

Commercial Advisers is a wholly-owned TRS that is subject to federal and state income taxes. Though Commercial Advisers has had no activity to date, the Company would account for any future income taxes in accordance with the provisions of ASC 740, *Income Taxes*. Under ASC 740-10-25, the Company accounts for income taxes using the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

### ***Segment Information***

ASC 280, *Segment Reporting*, provides standards for public companies relating to the reporting of financial and descriptive information about their operating segments in financial statements. Operating segments are defined as components of an enterprise for which separate financial information is available and is evaluated regularly by the chief operating decision maker or decision making group in determining how to allocate resources and in assessing performance. Company Management is the chief decision making group. As discussed in Note 9, the Company's operations are derived from two operating segments, one segment purchases real estate (land, buildings and other improvements), which is simultaneously leased to existing users, and the other segment originates mortgage loans and collects principal and interest payments. The Company had no mortgage loans receivable outstanding as of December 31, 2010.

### ***Asset Retirement Obligations***

ASC 410, *Asset Retirement and Environmental Obligation*, requires an entity to recognize a liability for a conditional asset retirement obligation when incurred if the liability can be reasonably estimated. ASC 410-20-20 clarifies that the term *Conditional Asset Retirement Obligation* refers to a legal obligation (pursuant to existing laws or by contract) to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. ASC 410-20-25-6 clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The Company has accrued a liability and corresponding increase to the cost of the related properties for disposal related to all properties constructed prior to 1985 that have, or may have, asbestos present in the building. In that regard, the Company accrued a liability of \$615,000 during the years ended December 31, 2010, in relation to the acquisition of one property in Orange City, Iowa. No such liability was accrued for the year ended December 31, 2009, as no acquisitions were made and no events occurred that would require an adjustment to the Company's original estimate. The Company also recorded expenses of approximately \$143,000, \$144,000 and \$133,000 during the years ended December 31, 2010, 2009 and 2008 respectively, related to the cumulative accretion of the obligation.

### ***Stock Issuance Costs***

The Company accounts for stock issuance costs in accordance with SEC Staff Accounting Bulletin ( *SAB* ) Topic 5.A, which states that incremental costs directly attributable to a proposed or actual offering of securities should be deferred and charged against the gross proceeds of the offering. Accordingly, the Company records costs incurred related to its ongoing equity offerings to other assets on its consolidated balance sheet and ratably applies these amounts to the cost of equity as stock is issued. If an equity offering is subsequently terminated and there are amounts remaining in other assets that have not been

## **Table of Contents**

allocated to the cost of the offering, the remaining amounts are recorded as an expense on the consolidated income statement. Accordingly, in connection with the termination of the Company's private offering of unregistered senior common stock, it wrote-off approximately \$1.6 million of fees and expenses incurred related to the offering. The expenses consisted primarily of legal, accounting and fees paid to Halcyon, and are recorded as professional fees in the Company's consolidated statement of operations.

### ***Other Income***

The Company records non-operating and unusual or infrequently earned income as other income on its consolidated statement of operations. Accordingly, the Company recorded the \$3.3 million of prepayment fees it received in connection with the early payment of its mortgage loan as other income.

### ***Real Estate Held for Sale and Discontinued Operations***

ASC 360-10, Property, Plant, and Equipment, requires that the results of operations of any properties which have been sold, or are held for sale, be presented as discontinued operations in the Company's consolidated financial statements in both current and prior periods presented. Income items related to held for sale properties are listed separately on the Company's consolidated income statement. Real estate assets held for sale are measured at the lower of the carrying amount or the fair value, less the cost to sell, and are listed separately on the Company's consolidated balance sheet. Once properties are listed as held for sale, no further depreciation is recorded.

### ***Recently Issued Accounting Pronouncements***

ASC 810-10-25-38, Consolidation, amends the consolidation guidance for variable-interest entities ( VIE ) and requires an enterprise to qualitatively assess the determination of the primary beneficiary of a VIE based on whether the entity has the power to direct matters that most significantly impact the activities of the VIE, and had the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. ASC 810 is effective for the Company's fiscal year beginning January 1, 2010. The Company adopted this pronouncement during the quarter ended March 31, 2010, and the adoption has had no impact on the Company's financial position or results of operations.

### ***Use of Estimates***

The preparation of financial statements in conformity with 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from those estimates.

## **2. Related-Party Transactions**

The Company is externally managed pursuant to contractual arrangements with its Adviser and Gladstone Administration, LLC (the Administrator ), which collectively employ all of the Company's personnel and pays their payroll, benefits, and general expenses directly. The Company has an advisory agreement with its Adviser (the

Advisory Agreement ) and an administration agreement with its Administrator (the Administration Agreement ). The management services and administrative fees under the Advisory and Administration Agreements are described below. As of December 31, 2010 and December 31, 2009, respectively, approximately \$1.0 million and \$1.2 million were due to the Adviser.

### ***Advisory Agreement***

The Advisory Agreement provides for an annual base management fee equal to 2% of the Company's total stockholders' equity, less the recorded value of any preferred stock ( common stockholders' equity ), and an incentive fee based on funds from operations ( FFO ). For the years ended December 31, 2010, 2009 and 2008 the Company recorded a base management fee of approximately \$1.2 million, \$1.4 million and

## **Table of Contents**

\$1.6 million, respectively. The Advisor's Board of Directors voted to give the Company a credit to the base management fee for the year ended December 31, 2010 of \$225,000. For purposes of calculating the incentive fee, FFO includes any realized capital gains and capital losses, less any distributions paid on preferred stock, but FFO does not include any unrealized capital gains or losses. The incentive fee rewards the Advisor if the Company's quarterly FFO, before giving effect to any incentive fee (pre-incentive fee FFO), exceeds 1.75%, or 7% annualized (the hurdle rate), of total common stockholders' equity. The Advisor receives 100% of the amount of the pre-incentive fee FFO that exceeds the hurdle rate, but is less than 2.1875% of the Company's common stockholders' equity. The Advisor also receives an incentive fee of 20% of the amount of the Company's pre-incentive fee FFO that exceeds 2.1875% of common stockholders' equity.

For the years ended December 31, 2010, 2009 and 2008 the Company recorded an incentive fee of approximately \$3.5 million, \$3.2 million and \$2.8 million, respectively, offset by a credit related to an unconditional and irrevocable voluntary waiver issued by the Advisor of approximately \$0.2, \$0.7 million and \$2.2 million, respectively, resulting in a net incentive fee for the year ended December 31, 2010, of approximately \$3.3 million, \$2.5 million and \$0.6 million, respectively. The board of directors of the Company accepted the Advisor's offer to waive on a quarterly basis a portion of the incentive fee for the years ended December 31, 2010, 2009 and 2008 in order to support the current level of distributions to the Company's stockholders. These waivers may not be recouped by the Advisor in the future.

### ***Administration Agreement***

Pursuant to the Administration Agreement, the Company pays for its allocable portion of the Administrator's overhead expenses in performing its obligations to the Company, including, but not limited to, rent, and the salaries and benefits of its chief financial officer, chief compliance officer, internal counsel, treasurer, investor relations and their respective staffs. The Company's allocable portion of expenses is derived by multiplying the Administrator's total allocable expenses by the percentage of the Company's total assets at the beginning of each quarter in comparison to the total assets of all companies managed by the Advisor under similar agreements. For the years ended December 31, 2010, 2009 and 2008 the Company recorded an administration fee of approximately \$1.1 million, \$1.0 million and \$1.0 million, respectively.

### **3. Earnings per Share of Common Stock**

The following tables set forth the computation of basic and diluted earnings per share of common stock for the years ended December 31, 2010, 2009 and 2008. The Company computed basic earnings per share for the year ended December 31, 2010, 2009 and 2008 using the weighted average number of shares outstanding during the periods. Diluted earnings per share for the year ended December 31, 2010, reflects additional shares of common stock, related to our convertible senior common stock, that would have been outstanding if dilutive potential shares of common stock had been issued, as well as an adjustment to net income available to common stockholders as applicable to common stockholders that would result from their assumed issuance.

**Table of Contents**

|                                                                      | For the year ended December 31, |            |            |
|----------------------------------------------------------------------|---------------------------------|------------|------------|
|                                                                      | 2010                            | 2009       | 2008       |
| <b>Calculation of basic earnings per share of common stock:</b>      |                                 |            |            |
| Net income available to common stockholders                          | \$ 814,108                      | \$ 509,298 | \$ 819,197 |
| Denominator for basic weighted average shares of common stock        | 8,576,303                       | 8,563,264  | 8,565,149  |
| Basic earnings per share of common stock                             | \$ 0.09                         | \$ 0.06    | \$ 0.10    |
| <b>Calculation of diluted earnings per share of common stock:</b>    |                                 |            |            |
| Net income available to common stockholders                          | \$ 814,108                      | \$ 509,298 | \$ 819,197 |
| Add: Income impact of assumed conversion of senior common stock      | 20,050                          |            |            |
| Net income available to common stockholders plus assumed conversions | \$ 834,158                      | \$ 509,298 | \$ 819,197 |
| Denominator for basic weighted average shares of common stock        | 8,576,303                       | 8,563,264  | 8,565,149  |
| Effect of convertible senior common stock                            | 24,850                          |            |            |
| Denominator for diluted weighted average shares of common stock      | 8,601,153                       | 8,563,264  | 8,565,149  |
| Diluted earnings per share of common stock                           | \$ 0.09                         | \$ 0.06    | \$ 0.10    |

**4. Real Estate and Intangible Assets***Real Estate*

The following table sets forth the components of the Company's investments in real estate, including capitalized leases, as of December 31, 2010 and 2009:

|                           | December 31,<br>2010         | December 31,<br>2009         |
|---------------------------|------------------------------|------------------------------|
| Real estate:              |                              |                              |
| Land                      | \$ 55,157,807 <sup>(1)</sup> | \$ 55,025,707 <sup>(1)</sup> |
| Building and improvements | 335,575,857                  | 325,907,479                  |
| Tenant improvements       | 10,283,276                   | 9,820,706                    |
| Accumulated depreciation  | (43,659,456)                 | (34,111,952)                 |
| Real estate, net          | \$ 357,357,484               | \$ 356,641,940               |

(1) Includes land held under a capital lease carried at approximately \$1.1 million.

During the year ended December 31, 2010, the Company acquired one property, which is summarized below:  
On December 15, 2010, the Company acquired a 487,121 square foot office/industrial building located in Orange City, Iowa for approximately \$12.3 million, including related acquisition expenses of \$386,000. The Company funded this acquisition through a combination of borrowings from its line of credit and the assumption of approximately \$10.8 million of mortgage debt on the property. At closing, the Company was assigned the existing triple net lease with Staples Contract & Commercial, Inc., the commercial delivery and fulfillment division of Staples, Inc. The existing triple net lease has a remaining term of approximately 16 years, and the mortgage debt related to the property matures in December 2026. The tenant has four options to extend the lease for additional periods of five years each. The existing triple net lease provides for aggregate rents of approximately \$1.2 million in 2011 with prescribed annual rental rate escalations commencing in 2012.  
In accordance with ASC 805 the Company allocated the purchase price of the property acquired during the year ended December 31, 2010 as follows:

**Table of Contents**

|                         |            |              |                        |                    |                  | Customer      | Discount on<br>Assumed | Total<br>Purchase<br>Price |
|-------------------------|------------|--------------|------------------------|--------------------|------------------|---------------|------------------------|----------------------------|
|                         | Land       | Building     | Tenant<br>Improvements | In-place<br>Leases | Leasing<br>Costs | Relationships | Debt                   |                            |
| Orange<br>City,<br>Iowa | \$ 132,100 | \$ 8,306,160 | \$ 462,570             | \$ 1,076,020       | \$ 245,583       | \$ 499,255    | \$ 1,285,757           | \$ 12,007,445              |
|                         | \$ 132,100 | \$ 8,306,160 | \$ 462,570             | \$ 1,076,020       | \$ 245,583       | \$ 499,255    | \$ 1,285,757           | \$ 12,007,445              |

Future operating lease payments from tenants under non-cancelable leases, excluding tenant reimbursement of expenses, for each of the five succeeding fiscal years and thereafter is as follows:

| Year       | Tenant<br>Lease Payments |
|------------|--------------------------|
| 2011       | \$ 39,643,943            |
| 2012       | 39,768,059               |
| 2013       | 35,346,189               |
| 2014       | 31,246,937               |
| 2015       | 27,180,934               |
| Thereafter | 174,244,975              |

In accordance with the lease terms, substantially all tenant expenses are required to be paid by the tenant; however, the Company would be required to pay property taxes on the respective properties, and ground lease payments on the property located in Tulsa, Oklahoma, in the event the tenant fails to pay them. The total annualized property taxes for all properties held by the Company at December 31, 2010 was approximately \$6.2 million, and the total annual ground lease payments on the property located in Tulsa, Oklahoma was approximately \$153,000.

On May 4, 2010, the Company extended the lease with the tenant that occupies its property located in Grand Rapids, Michigan for a period of 15 years, and the tenant has two options to extend the lease for additional periods of 10 years each. The lease was originally set to expire in July 2016, and will now expire in April 2025. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$1.1 million. On September 29, 2010, the tenant occupying the building located in Hazelwood, Missouri declared bankruptcy. The lease for this property is scheduled to expire in January 2012, and rental income from this tenant comprises less than 1% of the Company's total annualized rental income. On March 2, 2011, the lease was rejected in the bankruptcy proceedings of the Company's tenant. The Company has been informed that the rent payments will cease at the end of April 2011. The Company is taking the appropriate action to re-tenant the property.

On October 8, 2010, the Company extended the lease with the tenant that occupies its property located in Toledo, Ohio for a period of 10 years, and the tenant has two options to extend the lease for additional periods of 10 years each. The lease was originally set to expire in December 2010, and will now expire in December 2020. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$276,000.

On December 14, 2010, the Company released the current tenant in its property located in Cumming, Georgia from its obligations under their existing lease, and simultaneously signed a lease with a new tenant under substantially the same terms. The new tenant is an Atlanta, Georgia based hospital system that acquired part of the current tenant's business, part of which is housed in the Company's Cumming, Georgia facility. The current tenant is a medical group that continues to lease the remainder of its properties

**Table of Contents**

located in Georgia under a master lease. In connection with services provided directly by the Company's Adviser to the tenant, the tenant paid a real estate advisory fee to the Company's Adviser, in the amount of \$450,000.

On December 30, 2010, the Company extended the lease with the tenant that occupies its property located in Fridley, Minnesota for a period of 10 years, and the tenant has one option to extend the lease for a period of 5 years. The lease was originally set to expire in January 2013 and will now expire in July 2020. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$812,000.

**Intangible Assets**

The following table summarizes the net value of other intangible assets and the accumulated amortization for each intangible asset class:

|                        | December 31, 2010 |                 | December 31, 2009 |                 |
|------------------------|-------------------|-----------------|-------------------|-----------------|
|                        | Lease             | Accumulated     | Lease             | Accumulated     |
|                        | Intangibles       | Amortization    | Intangibles       | Amortization    |
| In-place leases        | \$ 17,011,466     | \$ (8,362,167)  | \$ 15,935,445     | \$ (6,741,817)  |
| Leasing costs          | 10,763,570        | (4,684,857)     | 10,053,004        | (3,832,623)     |
| Customer relationships | 17,635,756        | (5,616,776)     | 17,136,501        | (4,373,049)     |
|                        | \$ 45,410,792     | \$ (18,663,800) | \$ 43,124,950     | \$ (14,947,489) |

The estimated aggregate amortization expense for each of the five succeeding fiscal years and thereafter is as follows:

| Year       | Estimated Amortization Expense |
|------------|--------------------------------|
| 2011       | \$ 5,900,964                   |
| 2012       | 4,617,520                      |
| 2013       | 2,589,117                      |
| 2014       | 2,343,203                      |
| 2015       | 1,968,738                      |
| Thereafter | 9,327,450                      |

**5. Real Estate Held for Sale and Discontinued Operations**

As of June 30, 2009, the Company classified its property in Norfolk, Virginia as held for sale under the provisions of ASC 360-10, which requires that the results of operations of any properties which have been sold, or are held for sale, be presented as discontinued operations in the Company's consolidated financial statements in both current and prior periods presented. On July 17, 2009, the Company sold this property for \$1.15 million, and recognized a gain on the sale of approximately \$160,000.

The table below summarizes the components of income from discontinued operations:

**Table of Contents**

|                                     | For the year ended December 31, |            |            |
|-------------------------------------|---------------------------------|------------|------------|
|                                     | 2010                            | 2009       | 2008       |
| Operating revenue                   | \$                              | \$ 56,202  | \$ 103,501 |
| Operating expense                   |                                 | (13,140)   | (63,575)   |
| Gain on sale of real estate         |                                 | 160,038    |            |
| Income from discontinued operations | \$                              | \$ 203,100 | \$ 39,926  |

**6. Mortgage Note Receivable**

On April 15, 2005, the Company originated a mortgage loan in the amount of \$10.0 million that was collateralized by an office building located in McLean, Virginia in which the Company's Adviser and Administrator are subtenants. The mortgage loan was originally scheduled to mature in May 2017 but, on July 22, 2010 this mortgage was fully repaid. The Company received \$3.3 million of additional income and prepayment fees in connection with the early payment, which was recorded as other income in the consolidated statement of operations.

**Table of Contents****7. Mortgage Notes Payable and Line of Credit**

The Company's mortgage notes payable and line of credit as of December 31, 2010 and 2009 are summarized below:

|                                                 | Date of<br>Issuance/<br>Assumption | Principal<br>Maturity<br>Date | Stated<br>Interest<br>Rate at<br>December<br>31, 2010<br>(1) | Principal Balance Outstanding<br>December 31,<br>2010<br>December 31,<br>2009 |                |
|-------------------------------------------------|------------------------------------|-------------------------------|--------------------------------------------------------------|-------------------------------------------------------------------------------|----------------|
| Fixed-Rate Mortgage Notes Payable:              |                                    |                               |                                                              |                                                                               |                |
|                                                 | 09/15/08                           | 10/01/11 <sup>(2)</sup>       | 4.58%                                                        | \$ 48,015,000                                                                 | \$ 48,015,000  |
|                                                 | 02/21/06                           | 12/01/13                      | 5.91%                                                        | 9,021,517                                                                     | 9,188,044      |
|                                                 | 02/21/06                           | 06/30/14                      | 5.20%                                                        | 18,740,559                                                                    | 19,116,277     |
|                                                 | 08/25/05                           | 09/01/15                      | 5.33%                                                        | 20,771,247                                                                    | 21,093,917     |
|                                                 | 09/12/05                           | 09/01/15                      | 5.21%                                                        | 12,209,365                                                                    | 12,389,647     |
|                                                 | 12/21/05                           | 12/08/15                      | 5.71%                                                        | 18,727,935                                                                    | 18,991,934     |
|                                                 | 09/06/07                           | 12/11/15                      | 5.81%                                                        | 4,291,947                                                                     | 4,361,144      |
|                                                 | 03/29/06                           | 04/01/16                      | 5.92%                                                        | 17,000,000                                                                    | 17,000,000     |
|                                                 | 04/27/06                           | 05/05/16                      | 6.58%                                                        | 13,719,529                                                                    | 14,009,918     |
|                                                 | 08/29/08                           | 06/01/16                      | 6.80%                                                        | 6,162,508                                                                     | 6,296,505      |
|                                                 | 11/22/06                           | 12/01/16                      | 5.76%                                                        | 13,954,519                                                                    | 14,136,921     |
|                                                 | 12/22/06                           | 01/01/17                      | 5.79%                                                        | 21,329,510                                                                    | 21,605,106     |
|                                                 | 02/08/07                           | 03/01/17                      | 6.00%                                                        | 13,775,000                                                                    | 13,775,000     |
|                                                 | 06/05/07                           | 06/08/17                      | 6.11%                                                        | 14,240,000                                                                    | 14,240,000     |
|                                                 | 10/15/07                           | 11/08/17                      | 6.63%                                                        | 15,474,173                                                                    | 15,657,330     |
|                                                 | 12/15/10                           | 12/10/26                      | 6.63%                                                        | 10,795,004                                                                    |                |
|                                                 | 03/16/05                           | 04/01/30                      | 6.33%                                                        | 2,641,650                                                                     | 2,884,908      |
| Total Fixed-Rate Mortgage Notes Payable:        |                                    |                               |                                                              | 260,869,463                                                                   | 252,761,651    |
| Variable-Rate Line of Credit:                   | 12/28/10                           | 12/27/13                      | LIBOR<br>+3.00%                                              | 27,000,000                                                                    | 33,200,000     |
| Total Mortgage Notes Payable and Line of Credit |                                    |                               |                                                              | \$ 287,869,463                                                                | \$ 285,961,651 |

<sup>(1)</sup> The weighted average interest rate on all debt outstanding at December 31, 2010 was approximately 5.43%.

- (2) This note has three annual extension options, which gives the Company the ability to extend the term of the note until October 1, 2013. The first of these options was exercised on September 30, 2010.

*Mortgage Notes Payable*

As of December 31, 2010, the Company had 17 fixed-rate mortgage notes payable, collateralized by a total of 56 properties. The obligors under each of these notes are wholly-owned separate borrowing entities, which own the real estate collateral. The Company is not a co-borrower, but has limited recourse liabilities that could result from: a borrower voluntarily filing for bankruptcy, improper conveyance of a property, fraud or material misrepresentation, misapplication or misappropriation of rents, security deposits, insurance proceeds or condemnation proceeds, and physical waste or damage to the property, resulting from a borrower's gross negligence or willful misconduct. The Company will also indemnify lenders against claims resulting from the presence of hazardous substances or activity involving hazardous substances in violation of environmental laws on a property. The weighted-average interest rate on the mortgage notes payable as of December 31, 2010 was approximately 5.65% and as of December 31, 2009 was approximately 6.00%.

The Company had \$48.0 million of balloon principal payments maturing under one of its long-term mortgages in 2010; however, the mortgage has three annual extension options through 2013, and the Company exercised one of these options on September 30, 2010. In connection with the exercise of the option, the interest rate reset from 6.85% to 4.58% through September 30, 2011. At the time of notification of extension, the Company remitted a fee of 0.25% of the outstanding principal balance, or approximately \$120,000, which is recorded as a deferred financing cost in the Company's consolidated balance sheet. The Company also remitted a certification to the lender that its aggregate debt service coverage ratio is not less

**Table of Contents**

than 1.2, thus the Company was in compliance with all covenants under the mortgage loan. The interest rate for the two additional extension periods will adjust based upon the 1-year swap rate at the time of extension and a fixed spread of 4.29% and 4.41%, respectively. In addition, one of the buildings pledged as collateral to the \$48.0 million mortgage is the building located in South Hadley, Massachusetts, in which the tenant did not renew its lease. The Company has until May 31, 2011 to pay off the portion of the loan allocated to the South Hadley property. The payoff amount is 115% of the allocated loan amount or approximately \$2.8 million.

On December 15, 2010, the Company assumed approximately \$10.8 million of indebtedness pursuant to a long-term note payable from Modern Woodmen of America, in connection with the Company's acquisition, on the same date, of a property located in Orange City, Iowa. The note accrues interest at a rate of 6.625% per year, and the Company may not repay this note prior to maturity, or it would be subject to a substantial prepayment penalty. The note matures on December 10, 2026.

The fair market value of all fixed-rate mortgage notes payable outstanding as of December 31, 2010 was approximately \$252.6 million, as compared to the carrying value stated above of approximately \$260.9 million. The fair market value is calculated based on a discounted cash flow analysis, using interest rates based on Management's estimate of interest rates on long-term debt with comparable terms.

Scheduled principal payments of mortgage notes payable for each of the five succeeding fiscal years and thereafter are as follows:

| Year       | Scheduled principal payments |
|------------|------------------------------|
| 2011       | \$ 51,456,852 <sup>(1)</sup> |
| 2012       | 3,792,260                    |
| 2013       | 12,616,579                   |
| 2014       | 21,251,589                   |
| 2015       | 55,082,307                   |
| Thereafter | 116,669,876                  |
|            | \$ 260,869,463               |

- (1) The \$48.0 million mortgage note issued in September 2008 was extended September 30, 2010 for one year. The Company expects to exercise additional options to extend the maturity date until October 2013.

*Line of Credit*

In December 2010, the Company procured a new \$50.0 million line of credit, or the New Line of Credit, with Capital One, N.A. serving as a revolving lender, a letter of credit issuer and as an administrative agent and Branch Banking and Trust Company serving as a revolving lender and a letter of credit issuer, which matures on December 28, 2013. The New Line of Credit replaced the Company's prior \$50.0 million senior secured revolving credit facility which was scheduled to mature on December 29, 2010, or the Prior Line of Credit. The New Line of Credit provides for a senior secured revolving credit facility of up to \$50.0 million, with a standby letter of credit sublimit of up to \$20.0 million. The New Line of Credit is subject to a maximum borrowing base calculation which may, from time to time, affect the maximum amount available to be drawn. The New Line of Credit may, upon satisfaction of certain conditions, be expanded up to \$75.0 million. Currently, eight of the Company's properties are pledged as collateral under its line of credit. The interest rate per annum applicable to the New Line of Credit is equal to the London Interbank Offered Rate, or LIBOR, plus an applicable margin of up to 3.00% depending upon the Company's

## **Table of Contents**

leverage. The leverage ratio used in determining the applicable margin for interest on the New Credit Line is recalculated quarterly. The Company will be subject to an annual maintenance fee of 0.25% per year. The Company's ability to access this source of financing is subject to its continued ability to meet customary lending requirements such as compliance with financial and operating covenants and its meeting certain lending limits. One such covenant requires the Company to limit distributions to its stockholders to 95% of our FFO, with acquisition-related costs required to be expensed under ASC 805 added back to FFO. In addition, the maximum amount the Company may draw under this agreement is based on a percentage of the value of properties pledged as collateral to the banks, which must meet agreed upon eligibility standards. The maximum amount that the Company may currently draw under the New Line of Credit is approximately \$38.8 million. Furthermore, those eight properties that are pledged as collateral to the banks are pledged through a perfected first priority lien in the equity interest of the special purpose entity, or SPE, that owns the property. In addition, Gladstone Commercial Limited Partnership, a Delaware limited partnership that owns the SPEs, or the Operating Partnership, is precluded from transferring the SPEs or unconsolidated affiliates to the Company.

If and when long-term mortgages are arranged for these pledged properties, the banks will release the properties from the line of credit and reduce the availability under the line of credit by the advanced amount of the released property. Conversely, as the Company purchases new properties meeting the eligibility standards, it may pledge these new properties to obtain additional availability under this agreement. The availability under the line of credit will also be reduced by letters of credit used in the ordinary course of business. The Company may use the advances under the line of credit for both general corporate purposes and the acquisition of new investments.

At December 31, 2010, there was \$27.0 million outstanding under the line of credit at an interest rate of approximately 3.3% and approximately \$5.9 million outstanding under letters of credit at a weighted average interest rate of approximately 3.0%. At December 31, 2010, the remaining borrowing capacity available under the line of credit was approximately \$5.9 million. The Company's ability to increase the availability under its line of credit is dependent upon its pledging additional properties as collateral. Traditionally, the Company has pledged new properties to the line of credit as it arranges for long-term mortgages for these pledged properties. Currently, only nine of the Company's properties do not have long-term mortgages, and eight of those are pledged as collateral under its line of credit. Accordingly, the Company has only one property which is unencumbered, and which may be pledged as collateral to increase the borrowing capacity available under the line of credit. The Company was in compliance with all covenants under the New Line of Credit as of December 31, 2010. The amount outstanding on the line of credit as of December 31, 2010 approximates fair market value, because the debt is short-term and variable rate.

### **8. Stockholders' Equity**

Distributions paid per common share for each of the years ended December 31, 2010, 2009 and 2008 were \$1.50, per share. Distributions paid per share of Series A Preferred Stock for each of the years ended December 31, 2010, 2009 and 2008 were approximately \$1.94 per share. Distributions paid per share of Series B Preferred Stock for each of the years ended December 31, 2010, 2009 and 2008 were approximately \$1.88 per share. Distributions paid per share of senior common stock for the year ended December 31, 2010 were \$0.5979 per share. There were no distributions paid to senior common stockholders for either of the years ended December 31, 2009 or 2008, as no senior common stock was outstanding during this period.

For Federal income tax purposes, distributions paid to stockholders may be characterized as ordinary income, capital gains or return of capital. The characterization of distributions during each of the last three years is reflected in the table below:

**Table of Contents**

|                                                                                                                                 | Ordinary<br>Income | Return of<br>Capital | Long-Term<br>Capital<br>Gains |
|---------------------------------------------------------------------------------------------------------------------------------|--------------------|----------------------|-------------------------------|
| Common Stock                                                                                                                    |                    |                      |                               |
| For the year ended December 31, 2008                                                                                            | 9.26770%           | 90.73230%            | 0.00000%                      |
| For the year ended December 31, 2009                                                                                            | 6.04080%           | 93.95920%            | 0.00000%                      |
| For the year ended December 31, 2010                                                                                            | 15.76540%          | 84.23460%            | 0.00000%                      |
| Series A Preferred Stock                                                                                                        |                    |                      |                               |
| For the year ended December 31, 2008                                                                                            | 100.00000%         | 0.00000%             | 0.00000%                      |
| For the year ended December 31, 2009                                                                                            | 100.00000%         | 0.00000%             | 0.00000%                      |
| For the year ended December 31, 2010                                                                                            | 100.00000%         | 0.00000%             | 0.00000%                      |
| Series B Preferred Stock                                                                                                        |                    |                      |                               |
| For the year ended December 31, 2008                                                                                            | 100.00000%         | 0.00000%             | 0.00000%                      |
| For the year ended December 31, 2009                                                                                            | 100.00000%         | 0.00000%             | 0.00000%                      |
| For the year ended December 31, 2010                                                                                            | 100.00000%         | 0.00000%             | 0.00000%                      |
| The following table is a summary of all outstanding notes issued to employees of the Adviser for the exercise of stock options: |                    |                      |                               |

|             | Number of<br>Options | Strike<br>Price of<br>Options | Amount of<br>Promissory<br>Note<br>Issued to<br>Employees | Outstanding<br>Balance<br>of Employee<br>Loans<br>at December<br>31,<br>2010 | Outstanding<br>Balance<br>of Employee<br>Loans<br>at December<br>31,<br>2009 | Maturity Date<br>of Note | Interest<br>Rate<br>on Note |
|-------------|----------------------|-------------------------------|-----------------------------------------------------------|------------------------------------------------------------------------------|------------------------------------------------------------------------------|--------------------------|-----------------------------|
| Date Issued | Exercised            | Exercised                     |                                                           |                                                                              |                                                                              |                          |                             |
| Sep 2004    | 25,000               | \$ 15.00                      | \$ 375,000                                                | \$ 20,253                                                                    | \$ 358,405                                                                   | Sep 2013                 | 5.00%                       |
| Apr 2006    | 12,422               | 16.10                         | 199,994                                                   | 4,563                                                                        | 199,994                                                                      | Apr 2015                 | 7.77%                       |
| May 2006    | 50,000               | 16.85                         | 842,500                                                   | 531,417                                                                      | 842,500                                                                      | May 2016                 | 7.87%                       |
| May 2006    | 15,000               | 16.10                         | 241,500                                                   |                                                                              | 241,500                                                                      | May 2016                 | 7.87%                       |
| May 2006    | 2,000                | 16.10                         | 32,200                                                    | 32,200                                                                       | 32,200                                                                       | May 2016                 | 7.87%                       |
| May 2006    | 2,000                | 16.10                         | 32,200                                                    |                                                                              | 32,200                                                                       | May 2016                 | 7.87%                       |
| May 2006    | 2,000                | 15.00                         | 30,000                                                    |                                                                              | 30,000                                                                       | May 2016                 | 7.87%                       |
| Oct 2006    | 12,000               | 16.10                         | 193,200                                                   |                                                                              | 193,200                                                                      | Oct 2015                 | 8.17%                       |
| Nov 2006    | 25,000               | 15.00                         | 375,000                                                   | 375,000                                                                      | 375,000                                                                      | Nov 2015                 | 8.15%                       |
|             | 145,422              |                               | \$ 2,321,594                                              | \$ 963,433                                                                   | \$ 2,304,999                                                                 |                          |                             |

In accordance with ASC 505-10-45-2, Equity, receivables from employees for the issuance of capital stock to employees prior to the receipt of cash payment should be reflected in the balance sheet as a reduction to stockholders equity. Therefore, these notes were recorded as full recourse loans to employees and are included in the equity section of the accompanying consolidated balance sheets. As of December 31, 2010, each loan maintained its full recourse status.

On November 4, 2009, the Company entered into an open market sale agreement, or the Open Market Sale Agreement, with Jefferies & Company, Inc., or Jefferies, under which it may, from time to time, offer to sell shares of its common stock with an aggregate sales price of up to \$25.0 million on the open market through Jefferies, as agent, or to Jefferies, as principal. During the year ended December 31, 2010, the Company raised approximately \$3.4 million in net proceeds, through the sale of 192,365 shares of common stock under the Open Market Sale Agreement.

On November 19, 2009, the Company entered into a dealer manager agreement, or the Dealer Manager Agreement, as amended and restated on December 22, 2009, with Halcyon Capital Markets, LLC, or Halcyon, pursuant to which Halcyon agreed to act as its dealer manager in connection with its continuous private offering of up to 3,333,333 shares of its then newly designated unregistered senior common stock at \$15.00 per share. Holders of the unregistered senior common stock have the right, but not the obligation,

**Table of Contents**

following the fifth anniversary of the issuance of such shares, to exchange any or all of such shares of senior common stock for shares of the Company's common stock. On October 19, 2010, the Company terminated the private offering of unregistered senior common stock, including the dividend reinvestment plan for the senior common stock. In connection with the termination, the Company wrote-off approximately \$1.6 million of fees incurred in relation to the offering. The expenses consisted primarily of legal, accounting and fees paid to Halcyon, and are recorded as professional fees in the Company's consolidated statement of operations. The Company issued 59,057 shares of unregistered senior common stock pursuant to the private offering and related dividend reinvestment plan. Net proceeds from these sales, after selling commissions and dealer manager fees, were approximately \$787,000.

**9. Segment Information**

The Company's operations are comprised of two reportable segments. One segment purchases real estate (land, buildings and other improvements), which is simultaneously leased to existing users, and the other segment extends mortgage loans and collects principal and interest payments. As of December 31, 2010, the Company had no mortgage loans receivable outstanding. The amounts included under the Other column in the tables below include other income, which consists of interest income from temporary investments and employee loans and any other miscellaneous income earned, and operating and other expenses that were not specifically derived from either operating segment.

**Table of Contents**

The following table summarizes the Company's consolidated operating results and total assets by segment as of and for the years ended December 31, 2010, 2009 and 2008:

| As of and for the year ended December 31, 2010 |                        |                        |                            |                |
|------------------------------------------------|------------------------|------------------------|----------------------------|----------------|
|                                                | Real Estate<br>Leasing | Real Estate<br>Lending | Other                      | Total          |
| Operating revenues                             | \$ 41,507,237          | \$ 420,833             | \$                         | \$ 41,928,070  |
| Operating expenses                             | (14,790,124)           |                        | (8,624,448) <sup>(1)</sup> | (23,414,572)   |
| Other expense                                  | (16,065,957)           |                        | 2,480,367 <sup>(2)</sup>   | (13,585,590)   |
| Net income                                     | \$ 10,651,156          | \$ 420,833             | \$ (6,144,081)             | \$ 4,927,908   |
|                                                |                        |                        |                            |                |
| Total Assets                                   | \$ 400,616,254         | \$                     | \$ 9,992,348               | \$ 410,608,602 |

| As of and for the year ended December 31, 2009 |                        |                        |                            |                |
|------------------------------------------------|------------------------|------------------------|----------------------------|----------------|
|                                                | Real Estate<br>Leasing | Real Estate<br>Lending | Other                      | Total          |
| Operating revenues                             | \$ 41,848,520          | \$ 760,417             | \$                         | \$ 42,608,937  |
| Operating expenses                             | (14,260,070)           |                        | (6,280,459) <sup>(1)</sup> | (20,540,529)   |
| Other expense                                  | (16,480,535)           |                        | (1,187,925) <sup>(2)</sup> | (17,668,460)   |
| Discontinued operations                        | 203,100                |                        |                            | 203,100        |
| Net income                                     | \$ 11,311,015          | \$ 760,417             | \$ (7,468,384)             | \$ 4,603,048   |
|                                                |                        |                        |                            |                |
| Total Assets                                   | \$ 399,867,563         | \$ 10,000,000          | \$ 6,997,810               | \$ 416,865,373 |

| As of and for the year ended December 31, 2008 |                        |                        |                            |                |
|------------------------------------------------|------------------------|------------------------|----------------------------|----------------|
|                                                | Real Estate<br>Leasing | Real Estate<br>Lending | Other                      | Total          |
| Operating revenues                             | \$ 39,908,924          | \$ 898,573             | \$                         | \$ 40,807,497  |
| Operating expenses                             | (14,863,138)           |                        | (4,500,585) <sup>(1)</sup> | (19,363,723)   |
| Other expense                                  | (13,769,417)           |                        | (2,801,336) <sup>(2)</sup> | (16,570,753)   |
| Discontinued operations                        | 39,926                 |                        |                            | 39,926         |
| Net income                                     | \$ 11,316,295          | \$ 898,573             | \$ (7,301,921)             | \$ 4,912,947   |
|                                                |                        |                        |                            |                |
| Total Assets                                   | \$ 413,760,683         | \$ 10,000,000          | \$ 5,338,102               | \$ 429,098,785 |

(1)

Operating expenses includes base management fees, incentive fees, administration fees, professional fees, insurance expense, directors fees, stockholder-related expenses and general and administrative expenses that are not practicable to allocate to either operating segment; thus, these expenses are included in the Other column.

- (2) It is not practicable to allocate the interest expense from the line of credit or the short-term loan to either operating segment; thus, the interest is included in the Other column.

**Table of Contents****10. Pro Forma Financial Information (unaudited)**

The Company acquired one property during the year ended December 31, 2010. The following table reflects pro-forma condensed consolidated income statements as if the property was acquired as of the beginning of the periods presented:

|                                                                        | For the year ended December 31, |               |
|------------------------------------------------------------------------|---------------------------------|---------------|
|                                                                        | 2010                            | 2009          |
| <b>Operating Data:</b>                                                 |                                 |               |
| Total operating revenue                                                | \$ 43,031,138                   | \$ 43,712,005 |
| Total operating expenses                                               | (23,997,882)                    | (21,123,839)  |
| Other expense                                                          | (14,142,012)                    | (18,224,883)  |
| Income from continuing operations                                      | 4,891,244                       | 4,363,283     |
| Dividends attributable to preferred and senior common stock            | (4,113,800)                     | (4,093,750)   |
| Net income available from continuing operations to common stockholders | \$ 777,444                      | \$ 269,533    |

**Share and Per Share Data:**

|                                               |           |           |
|-----------------------------------------------|-----------|-----------|
| Basic net income from continuing operations   | \$ 0.09   | \$ 0.03   |
| Diluted net income from continuing operations | \$ 0.09   | \$ 0.03   |
| Weighted average shares outstanding-basic     | 8,576,303 | 8,563,264 |
| Weighted average shares outstanding-diluted   | 8,601,153 | 8,563,264 |

**11. Quarterly Financial Information (unaudited)**

The following table reflects the quarterly results of operations for the years ended December 31, 2010 and 2009.

**Table of Contents**

|                                                                | Quarter ended<br>March<br>31, 2010 | Quarter ended<br>June<br>30, 2010 | Quarter ended<br>September 30,<br>2010 | Quarter ended<br>December 31,<br>2010 |
|----------------------------------------------------------------|------------------------------------|-----------------------------------|----------------------------------------|---------------------------------------|
| Operating revenues                                             | \$ 10,684,976                      | \$ 10,681,387                     | \$ 10,334,413                          | \$ 10,227,294                         |
| Operating expenses                                             | 5,360,386                          | 5,350,201                         | 7,282,219                              | 5,421,766                             |
| Other expense                                                  | (4,238,257)                        | (4,324,735)                       | (1,023,942)                            | (3,998,656)                           |
| Income from continuing operations                              | 1,086,333                          | 1,006,451                         | 2,028,252                              | 806,872                               |
| Discontinued operations                                        |                                    |                                   |                                        |                                       |
| Net income                                                     | 1,086,333                          | 1,006,451                         | 2,028,252                              | 806,872                               |
| Dividends attributable to preferred<br>and senior common stock | (1,023,438)                        | (1,023,812)                       | (1,027,719)                            | (1,038,831)                           |
| Net income available to common<br>stockholders                 | 62,895                             | (17,361)                          | 1,000,533                              | (231,959)                             |
| Net income available to common<br>stockholders basic           | \$ 0.01                            | \$ 0.00                           | \$ 0.12                                | \$ (0.04)                             |
| Net income available to common<br>stockholders diluted         | \$ 0.01                            | \$ 0.00                           | \$ 0.12                                | \$ (0.04)                             |
| Weighted average shares<br>outstanding basic                   | 8,558,664                          | 8,545,264                         | 8,562,777                              | 8,637,981                             |
| Weighted average shares<br>outstanding diluted                 | 8,558,664                          | 8,546,529                         | 8,577,173                              | 8,688,900                             |
|                                                                | Quarter ended<br>March<br>31, 2009 | Quarter ended<br>June<br>30, 2009 | Quarter ended<br>September 30,<br>2009 | Quarter ended<br>December 31,<br>2009 |
| Operating revenues                                             | \$ 10,658,176                      | \$ 10,651,489                     | \$ 10,657,094                          | \$ 10,642,178                         |
| Operating expenses                                             | 5,165,052                          | 5,181,837                         | 5,069,018                              | 5,124,622                             |
| Other expense                                                  | (4,421,393)                        | (4,373,632)                       | (4,473,194)                            | (4,400,241)                           |
| Income from continuing operations                              | 1,071,731                          | 1,096,020                         | 1,114,882                              | 1,117,315                             |
| Discontinued operations                                        | 17,838                             | 20,916                            | 164,108                                | 238                                   |
| Net income                                                     | 1,089,569                          | 1,116,936                         | 1,278,990                              | 1,117,553                             |
| Distributions attributable to<br>preferred stock               | (1,023,437)                        | (1,023,437)                       | (1,023,437)                            | (1,023,439)                           |
| Net income available to common<br>stockholders                 | 66,132                             | 93,499                            | 255,553                                | 94,114                                |
| Net income available to common<br>stockholders basic & diluted | \$ 0.01                            | \$ 0.01                           | \$ 0.03                                | \$ 0.01                               |

|                                |           |           |           |           |
|--------------------------------|-----------|-----------|-----------|-----------|
| Weighted average shares        |           |           |           |           |
| outstanding    basic & diluted | 8,563,264 | 8,563,264 | 8,563,264 | 8,563,264 |

**12. Subsequent Events**

On January 11, 2011 the Company's Board of Directors declared a cash distribution of \$0.125 per share of common stock, \$0.1614583 per share of the Series A Preferred Stock, \$0.15625 per share of the Series B Preferred Stock, and \$0.0875 per share of the Senior common stock for each of the months of January, February and March of 2011.

Monthly distributions will be payable on January 31, 2011, February 28, 2011 and March 31, 2011, respectively, to stockholders of record as of the close of business on January 21, 2011, February 21, 2011 and March 21, 2011, respectively for shares of common stock and preferred stock Series A and Series B. Monthly distributions to senior common stockholders will be payable on the February 7, 2011, March 7, 2011, and April 6, 2011.

On January 31, 2011, the Company extended the lease with its tenant occupying its properties located in Decatur, Georgia, Lawrenceville, Georgia, Snellville, Georgia, Covington, Georgia, and Conyers, Georgia. The lease covering all of these properties was extended for an additional five year period, thereby extending the lease until December 2031. The lease was originally set to expire in December 2026. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$1.6 million. Furthermore, the lease grants the tenant four options to extend the lease for a period of five years each.

On February 2, 2011, the Company sold 725,000 shares of its common stock at \$18.35 per share in an underwritten public offering of its common stock. The Company also granted the underwriters a 30-day option to purchase up to 108,750 shares of common stock on the same terms and conditions to cover over-allotments, if any. On February 11, 2011 the underwriters executed their option to purchase an additional

**Table of Contents**

108,750 shares of common stock. The net proceeds after deducting the underwriting discount and estimated offering expenses were approximately \$14.3 million. The Company used the proceeds of the offering to repay a portion of the outstanding balance under its New Line of Credit.

**Table of Contents**

**GLADSTONE COMMERCIAL CORPORATION**  
**SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION**  
**DECEMBER 31, 2010**

| Property             | Encumbrances | Initial Cost |                          |         | Costs Capitalized Subsequent to Acquisition | Total Cost   |                          |                      | Net Real Estate |
|----------------------|--------------|--------------|--------------------------|---------|---------------------------------------------|--------------|--------------------------|----------------------|-----------------|
|                      |              | Land         | Buildings & Improvements |         |                                             | Land         | Buildings & Improvements | Total <sup>(1)</sup> |                 |
| g                    | \$ 4,940,000 | \$ 960,000   | \$ 4,480,772             | \$      | \$ 960,000                                  | \$ 4,480,772 | \$ 5,440,772             | \$ 1,224,039         | \$ 4,216,733    |
| ehouse               | 2,861,267    | 186,739      | 3,082,007                |         | 186,739                                     | 3,082,007    | 3,268,746                | 608,863              | 2,659,883       |
| oratory              | 7,332,602    | 1,974,000    | 6,769,565                | 284,926 | 1,974,000                                   | 7,054,491    | 9,028,491                | 1,189,088            | 7,839,403       |
| th                   | 6,802,185    | 741,296      | 8,423,389                | 59,190  | 741,296                                     | 8,482,579    | 9,223,875                | 1,434,701            | 7,789,174       |
| g                    | 2,641,649    | 150,000      | 5,050,000                |         | 150,000                                     | 5,050,000    | 5,200,000                | 838,882              | 4,361,118       |
| hip,                 | 5,544,454    | 100,000      | 6,573,902                | 156,129 | 100,000                                     | 6,730,031    | 6,830,031                | 1,090,252            | 5,739,779       |
| ilding<br>rth        | 2,809,628    | 819,760      | 2,106,845                | 6,637   | 819,760                                     | 2,113,479    | 2,933,239                | 347,677              | 2,585,562       |
| ilding               | 6,500,000    | 1,000,000    | 6,295,794                | 46,095  | 1,000,000                                   | 6,341,889    | 7,341,889                | 1,047,193            | 6,294,696       |
| g                    | 5,179,012    | 350,000      | 5,818,703                | 18,430  | 350,000                                     | 5,837,133    | 6,187,133                | 942,959              | 5,244,174       |
| Texas                | 7,080,146    | 843,000      | 7,513,750                | 22,673  | 843,000                                     | 7,536,423    | 8,379,423                | 1,503,338            | 6,876,085       |
| e                    | 2,695,221    | 410,000      | 2,385,108                |         | 410,000                                     | 2,385,108    | 2,795,108                | 363,906              | 2,431,202       |
| io<br>ding<br>y York | 5,630,000    | 275,000      | 6,459,318                | 33,666  | 275,000                                     | 6,492,984    | 6,767,984                | 957,299              | 5,810,685       |

|                                        |            |           |            |           |           |            |            |           |            |
|----------------------------------------|------------|-----------|------------|-----------|-----------|------------|------------|-----------|------------|
| as<br>g<br>as<br>Bakery                | 8,316,687  | 1,525,000 | 9,702,731  | 67,611    | 1,525,000 | 9,770,342  | 11,295,342 | 1,492,116 | 9,803,226  |
|                                        | 4,064,745  | 635,964   | 3,694,876  | 45,003    | 635,964   | 3,739,879  | 4,375,843  | 553,942   | 3,821,901  |
| g<br>ew                                | 2,015,496  | 525,000   | 1,876,992  | 119,736   | 525,000   | 1,996,728  | 2,521,728  | 402,992   | 2,118,736  |
| g<br>ynship,<br>ffice &<br>ilding<br>n | 4,580,000  | 1,350,630 | 3,520,062  | 306,681   | 1,350,630 | 3,826,743  | 5,177,373  | 572,203   | 4,605,170  |
|                                        | 6,790,000  | 1,631,534 | 6,199,849  |           | 1,631,534 | 6,199,849  | 7,831,383  | 872,739   | 6,958,644  |
| ehouse<br>n                            | 11,188,012 | 783,212   | 10,790,451 | 2,033,148 | 783,212   | 12,823,599 | 13,606,811 | 1,704,745 | 11,902,065 |
| g<br>Missouri<br>ehouse                | 2,781,050  | 194,686   | 2,682,227  |           | 194,686   | 2,682,227  | 2,876,913  | 423,756   | 2,453,158  |
|                                        | 2,360,000  | 763,178   | 2,309,058  | 29,962    | 763,178   | 2,339,020  | 3,102,198  | 339,523   | 2,762,675  |

Table of Contents

**GLADSTONE COMMERCIAL CORPORATION**  
**SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION (Continued)**  
**DECEMBER 31, 2010**

|          |              | Initial Cost |                             |             | Costs<br>Capitalized<br>Subsequent<br>to | Total Cost |                             |              | Accumulated<br>Depreciation<br>(2) | Net Real<br>Estate |
|----------|--------------|--------------|-----------------------------|-------------|------------------------------------------|------------|-----------------------------|--------------|------------------------------------|--------------------|
|          |              | Land         | Buildings &<br>Improvements | Acquisition |                                          | Land       | Buildings &<br>Improvements | Total (1)    |                                    |                    |
| Property | Encumbrances |              |                             |             |                                          |            |                             |              |                                    |                    |
| na       | \$ 584,212   | \$ 65,780    | \$ 1,074,758                | \$          |                                          | \$ 65,780  | \$ 1,074,758                | \$ 1,140,538 | \$ 130,045                         | \$ 1,010,493       |
| ding     | 1,168,415    | 131,559      | 1,129,874                   |             |                                          | 131,559    | 1,129,874                   | 1,261,433    | 260,088                            | 1,001,345          |
| inois    | 311,574      | 35,082       | 1,113,340                   |             |                                          | 35,082     | 1,113,341                   | 1,148,423    | 69,356                             | 1,079,067          |
| ding     |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| ding     | 6,684,145    | 628,690      | 6,504,056                   | 1,846,895   |                                          | 628,690    | 8,350,951                   | 8,979,641    | 1,001,587                          | 7,978,054          |
|          |              |              |                             |             |                                          |            |                             |              |                                    |                    |
|          | 3,338,643    | 54,674       | 4,717,090                   |             |                                          | 54,674     | 4,717,090                   | 4,771,764    | 643,190                            | 4,128,574          |
| s, Ohio  |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| ding     | 10,488,260   | 1,608,976    | 10,065,475                  | 1,123,464   |                                          | 1,608,976  | 11,188,940                  | 12,797,916   | 1,610,048                          | 11,187,868         |
| rginia   |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| ding     | 5,275,000    | 735,820      | 5,335,863                   | 36,437      |                                          | 735,820    | 5,372,300                   | 6,108,120    | 742,177                            | 5,365,943          |
| ding     |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| ding     | 2,929,073    | 263,068      | 2,811,801                   | 39,916      |                                          | 263,068    | 2,851,717                   | 3,114,785    | 435,452                            | 2,679,333          |
|          |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| ding     | 2,418,750    | 470,636      | 2,765,376                   | 10,000      |                                          | 470,636    | 2,775,376                   | 3,246,012    | 346,479                            | 2,899,533          |
| linois   |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| g        | 1,699,941    | 686,979      | 2,035,784                   | 10,546      |                                          | 686,979    | 2,046,330                   | 2,733,309    | 286,905                            | 2,446,405          |
| linois   |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| g        | 3,333,217    | 1,347,017    | 3,991,733                   |             |                                          | 1,347,017  | 3,991,733                   | 5,338,750    | 562,558                            | 4,776,192          |
| linois   |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| g        | 2,083,261    | 841,886      | 2,494,833                   |             |                                          | 841,886    | 2,494,833                   | 3,336,719    | 351,599                            | 2,985,120          |
| linois   |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| g        | 1,905,100    | 769,888      | 2,281,475                   |             |                                          | 769,888    | 2,281,475                   | 3,051,363    | 321,530                            | 2,729,833          |
| nesota   |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| g        | 18,740,559   | 2,587,757    | 25,290,127                  |             |                                          | 2,587,757  | 25,290,126                  | 27,877,883   | 3,842,042                          | 24,035,841         |
| nesota   |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| g        | 11,716,292   | 3,510,711    | 8,746,407                   |             |                                          | 3,510,711  | 8,746,407                   | 12,257,118   | 1,380,881                          | 10,876,237         |
| alls,    |              |              |                             |             |                                          |            |                             |              |                                    |                    |
| ding     | 6,940,000    | 624,700      | 6,910,616                   |             |                                          | 624,700    | 6,910,616                   | 7,535,316    | 810,716                            | 6,724,600          |

|                 |           |           |           |        |           |           |            |         |            |
|-----------------|-----------|-----------|-----------|--------|-----------|-----------|------------|---------|------------|
| as<br>g<br>ts,  | 2,000,000 | 221,314   | 2,443,469 |        | 221,314   | 2,443,469 | 2,664,783  | 323,500 | 2,341,283  |
| ding<br>Alabama |           | 2,734,887 | 8,606,190 | 12,676 | 2,734,887 | 8,618,866 | 11,353,753 | 944,550 | 10,409,203 |
| ding            |           | 611,597   | 2,325,761 |        | 611,597   | 2,325,761 | 2,937,358  | 259,784 | 2,677,574  |
| ding            |           | 221,965   | 844,081   |        | 221,965   | 844,081   | 1,066,046  | 94,283  | 971,764    |
|                 |           |           |           | 93     |           |           |            |         |            |

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**Table of Contents**

**GLADSTONE COMMERCIAL CORPORATION**  
**SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION (Continued)**  
**DECEMBER 31, 2010**

|          |              | Initial Cost |                             |        | Costs<br>Capitalized<br>Subsequent<br>to<br>Acquisition | Total Cost |                             |            | Accumulated<br>Depreciation<br>(2) | Net Real<br>Estate |
|----------|--------------|--------------|-----------------------------|--------|---------------------------------------------------------|------------|-----------------------------|------------|------------------------------------|--------------------|
|          |              | Land         | Buildings &<br>Improvements | Land   |                                                         | Land       | Buildings &<br>Improvements | Total (1)  |                                    |                    |
| Property | Encumbrances |              |                             |        |                                                         |            |                             |            |                                    |                    |
| Missouri |              |              |                             |        |                                                         |            |                             |            |                                    |                    |
| Building | \$           | \$ 145,988   | \$ 555,157                  | \$     | \$                                                      | \$ 145,988 | \$ 555,158                  | \$ 701,146 | \$ 62,010                          | \$ 639,135         |
| Building | 5,400,000    | 797,274      | 6,258,344                   | 47,471 |                                                         | 797,274    | 6,305,815                   | 7,103,089  | 810,732                            | 6,292,357          |
| Building | 5,470,120    | 1,605,551    | 5,513,353                   |        |                                                         | 1,605,551  | 5,513,353                   | 7,118,904  | 561,261                            | 6,557,643          |
| Building |              |              | 14,057,227                  |        |                                                         |            | 14,057,227                  | 14,057,227 | 1,619,901                          | 12,437,326         |
| Building |              | 3,562,452    | 6,671,600                   | 35,000 |                                                         | 3,562,452  | 6,706,600                   | 10,269,055 | 658,492                            | 9,610,563          |
| Building |              | 1,394,902    | 8,893,243                   |        |                                                         | 1,394,822  | 8,893,243                   | 10,288,065 | 894,631                            | 9,393,434          |
| Building | 4,825,041    | 1,201,338    | 4,960,987                   |        |                                                         | 1,201,338  | 4,960,987                   | 6,162,325  | 450,106                            | 5,712,219          |
| Building | 4,291,947    | 299,066      | 5,018,628                   |        |                                                         | 299,066    | 5,018,628                   | 5,317,694  | 427,155                            | 4,890,539          |
| Building | 9,225,000    | 1,629,270    | 10,500,066                  |        |                                                         | 1,629,270  | 10,500,066                  | 12,129,336 | 950,445                            | 11,178,891         |
| Building | 4,968,750    | 1,271,543    | 5,003,124                   |        |                                                         | 1,271,543  | 5,003,124                   | 6,274,667  | 445,792                            | 5,828,875          |
| Building |              | 784,188      | 3,245,281                   |        |                                                         | 784,188    | 3,245,281                   | 4,029,469  | 266,885                            | 3,762,585          |
| Building | 1,117,698    | 204,807      | 847,573                     |        |                                                         | 204,807    | 847,573                     | 1,052,380  | 69,703                             | 982,677            |
| Building | 1,403,002    | 257,086      | 1,063,925                   |        |                                                         | 257,086    | 1,063,925                   | 1,321,011  | 87,495                             | 1,233,516          |
| Building | 3,704,723    | 678,854      | 2,809,365                   |        |                                                         | 678,854    | 2,809,365                   | 3,488,219  | 231,036                            | 3,257,183          |
| Building | 961,622      | 176,208      | 729,217                     |        |                                                         | 176,208    | 729,217                     | 905,425    | 59,969                             | 845,456            |
| Building | 1,265,292    | 231,852      | 959,496                     |        |                                                         | 231,852    | 959,496                     | 1,191,348  | 78,907                             | 1,112,440          |
| Building | 4,028,089    | 738,107      | 3,054,580                   |        |                                                         | 738,107    | 3,054,580                   | 3,792,687  | 251,202                            | 3,541,484          |

|            |           |           |            |           |            |            |         |            |
|------------|-----------|-----------|------------|-----------|------------|------------|---------|------------|
| Georgia    |           |           |            |           |            |            |         |            |
| ling       |           |           |            |           |            |            |         |            |
| orgia      |           |           |            |           |            |            |         |            |
| ling       | 1,619,574 | 296,771   | 1,228,155  | 296,771   | 1,228,155  | 1,524,926  | 101,001 | 1,423,925  |
| nnsylvania |           |           |            |           |            |            |         |            |
| uilding    | 5,257,500 | 490,646   | 6,202,376  | 490,646   | 6,202,376  | 6,693,022  | 466,134 | 6,226,888  |
| nesota     |           |           |            |           |            |            |         |            |
| ling       |           | 1,354,233 | 8,073,526  | 1,354,233 | 8,073,526  | 9,427,759  | 892,652 | 8,535,107  |
| wnship,    |           |           |            |           |            |            |         |            |
| uilding    |           | 1,796,467 | 11,154,123 | 1,786,212 | 11,154,123 | 12,940,335 | 846,077 | 12,094,258 |
|            |           |           |            | 94        |            |            |         |            |

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Table of Contents

**GLADSTONE COMMERCIAL CORPORATION**  
**SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION**  
**DECEMBER 31, 2010**

|       | Initial Cost          |               |                             |              | Costs<br>Capitalized<br>Subsequent<br>to | Total Cost     |                             |               | Accumulated<br>Depreciation<br>(2) | Net Realizable<br>Estate |
|-------|-----------------------|---------------|-----------------------------|--------------|------------------------------------------|----------------|-----------------------------|---------------|------------------------------------|--------------------------|
|       | Property Encumbrances | Land          | Buildings &<br>Improvements | Acquisition  |                                          | Land           | Buildings &<br>Improvements | Total (1)     |                                    |                          |
| House | \$ 2,145,000          | \$ 669,025    | \$ 3,028,320                | \$ 6,000     | \$ 669,025                               | \$ 3,034,322   | \$ 3,703,345                | \$ 213,759    | \$ 3,489,586                       |                          |
|       | 4,500,000             | 829,014       | 6,607,265                   |              | 829,014                                  | 6,607,265      | 7,436,279                   | 400,169       | 7,036,110                          |                          |
|       | 6,162,508             | 1,249,415     | 6,419,607                   |              | 1,249,415                                | 6,419,607      | 7,669,022                   | 464,665       | 7,203,357                          |                          |
|       | 10,795,003            | 132,100       | 9,382,794                   |              | 132,100                                  | 9,382,794      | 9,514,894                   | 22,296        | 9,492,598                          |                          |
|       | \$ 260,869,463        | \$ 55,168,142 | \$ 339,460,840              | \$ 6,398,293 | \$ 55,157,807                            | \$ 345,859,133 | \$ 401,016,940              | \$ 43,659,456 | \$ 357,357,484                     |                          |

(1) The aggregate cost for land and building improvements for federal income tax purposes is the same as the total gross cost of land and building improvements.

(2) Depreciable life of all buildings is 39 years. Depreciable life of all improvements is the shorter of the useful life of the assets or the life of the respective leases on each building, which range from 5-20 years.

**Table of Contents**

The following table reconciles the change in the balance of real estate during the years ended December 31, 2010, 2009 and 2008, respectively:

|                                 | 2010           | 2009           | 2008           |
|---------------------------------|----------------|----------------|----------------|
| Balance at beginning of period  | \$ 390,753,892 | \$ 390,562,138 | \$ 340,500,406 |
| Acquisitions during period      | 8,900,830      |                | 47,874,020     |
| Improvements or other additions | 1,362,218      | 1,139,711      | 2,187,712      |
| Dispositions during period      |                | (947,957)      |                |
| Balance at end of period        | \$ 401,016,940 | \$ 390,753,892 | \$ 390,562,138 |

The following table reconciles the change in the balance of accumulated depreciation during the years ended December 31, 2010, 2009 and 2008, respectively:

|                                | 2010          | 2009          | 2008          |
|--------------------------------|---------------|---------------|---------------|
| Balance at beginning of period | \$ 34,111,952 | \$ 24,757,576 | \$ 15,738,634 |
| Additions during period        | 9,547,504     | 9,445,768     | 9,018,942     |
| Dispositions during period     |               | (91,392)      |               |
| Balance at end of period       | \$ 43,659,456 | \$ 34,111,952 | \$ 24,757,576 |

Table of Contents

**GLADSTONE COMMERCIAL CORPORATION**  
**SCHEDULE IV MORTGAGE LOANS ON REAL ESTATE**  
**DECEMBER 31, 2010**

|                                      |                |                                                              |                     |                                                                                                                                                                                                                                                        | Principal Amount of Loans Subject to Delinquent Carrying |               |          |
|--------------------------------------|----------------|--------------------------------------------------------------|---------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------|---------------|----------|
|                                      |                |                                                              |                     |                                                                                                                                                                                                                                                        | Face Amount                                              | Principal     | Interest |
| Location and Type                    | Type of Loan   | Interest Rate                                                | Final Maturity Date | Periodic Payment Term                                                                                                                                                                                                                                  | Prior Lien Mortgage                                      | Mortgage      | Interest |
| McLean, Virginia;<br>Office Property | First Mortgage | 1 month<br>LIBOR +6%;<br>Floor of<br>7.5%, Ceiling<br>of 10% | 5/30/2017           | Monthly payment based<br>upon a 24 year<br>amortization term, which<br>changes based on<br>LIBOR, with a floor of<br>7.5% and a ceiling of<br>10%. Payments are<br>interest only until June<br>2011.<br>Balloon payment at<br>maturity is \$8,221,344. |                                                          | \$ 10,000,000 | \$ \$    |
|                                      |                |                                                              |                     |                                                                                                                                                                                                                                                        |                                                          | \$ 10,000,000 | \$       |

(1) The mortgage loan was repaid in full on July 22, 2010.

The following table reconciles the change in the balance of mortgage loans on real estate during the years ended December 31, 2010, 2009 and 2008, respectively:

|                                | 2010          | 2009          | 2008          |
|--------------------------------|---------------|---------------|---------------|
| Balance at beginning of period | \$ 10,000,000 | \$ 10,000,000 | \$ 10,000,000 |
| Collections of principal       | (10,000,000)  |               |               |
| Balance at end of period       | \$            | \$ 10,000,000 | \$ 10,000,000 |

**Table of Contents**

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures**

**a) Evaluation of Disclosure Controls and Procedures**

As of December 31, 2010, our management, including our chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, management, including the chief executive officer and chief financial officer, concluded that our disclosure controls and procedures were effective as of December 31, 2010 in providing a reasonable level of assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in applicable SEC rules and forms, including providing a reasonable level of assurance that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate to allow timely decisions regarding required disclosure. However, in evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated can provide only reasonable assurance of necessarily achieving the desired control objectives, and management was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

**b) Management's Annual Report on Internal Control Over Financial Reporting**

Refer to Management's Report on Internal Controls over Financial Reporting located in Item 8 of this Form 10-K.

**c) Attestation Report of the Registered Public Accounting Firm**

Refer to the Report of Independent Registered Public Accounting Firm located in Item 8 of this Form 10-K.

**d) Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

None.

**Table of Contents**

**PART III**

We will file a definitive Proxy Statement for our 2011 Annual Meeting of Stockholders (the 2011 Proxy Statement ) with the Securities and Exchange Commission, pursuant to Regulation 14A, not later than 120 days after December 31, 2010. Accordingly, certain information required by Part III has been omitted under General Instruction G(3) to Form 10-K. Only those sections of the 2011 Proxy Statement that specifically address the items set forth herein are incorporated by reference.

**Item 10. Directors, Executive Officers and Corporate Governance**

The information required by Item 10 is hereby incorporated by reference from our 2011 Proxy Statement under the captions Election of Directors, Section 16(a) Beneficial Ownership Reporting Compliance and Code of Ethics.

**Item 11. Executive Compensation**

The information required by Item 11 is hereby incorporated by reference from our 2011 Proxy Statement under the captions Executive Compensation and Director Compensation.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by Item 12 is hereby incorporated by reference from our 2011 Proxy Statement under the caption Security Ownership of Certain Beneficial Owners and Management.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by Item 13 is hereby incorporated by reference from our 2011 Proxy Statement under the captions Transactions with Related Persons and Information Regarding the Board of Directors and Corporate Governance.

**Item 14. Principal Accountant Fees and Services**

The information required by Item 14 is hereby incorporated by reference from our 2011 Proxy Statement under the captions Independent Registered Public Accounting Firm Fees and Pre-Approval Policy and Procedures.

**Table of Contents**

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

**a. DOCUMENTS FILED AS PART OF THIS REPORT**

1. The following financial statements are filed herewith:

Report of Management on Internal Controls over Financial Reporting

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2010 and December 31, 2009

Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008

Consolidated Statements of Stockholders' Equity for the years ended December 31, 2010, 2009 and 2008

Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008

Notes to Financial Statements

2. Financial statement schedules

Schedule III Real Estate and Accumulated Depreciation is filed herewith.

Schedule IV Mortgage Loans on Real Estate is filed herewith.

All other schedules are omitted because they are not applicable, or because the required information is included in the financial statements or notes thereto.

3. Exhibits

The following exhibits are filed as part of this report or hereby incorporated by reference to exhibits previously filed with the Securities and Exchange Commission:

**Table of Contents**

**Exhibit Index**

| <b>Exhibit Number</b> | <b>Exhibit Description</b>                                                                                                                                                                                                                   |
|-----------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1                   | Articles of Amendment and Restatement to Articles of Incorporation, incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-11 (File No. 333-106024), filed June 11, 2003.                                          |
| 3.1.1                 | Articles Supplementary Establishing and Fixing the Rights and Preferences of the 7.75% Series A Cumulative Redeemable Preferred Stock, incorporated by reference to Exhibit 3.3 of Form 8-A12G (File No. 000-50363), filed January 19, 2006. |
| 3.1.2                 | Articles of Amendment to Articles Supplementary Establishing and Fixing the Rights and Preferences of 7.75% Series A Cumulative Redeemable Preferred Stock, incorporated by reference to Exhibit 99.1 of Form 8-K, filed on April 13, 2006.  |
| 3.1.3                 | Articles Supplementary Establishing and Fixing the Rights and Preferences of the 7.5% Series B Cumulative Redeemable Preferred Stock, incorporated by reference to Exhibit 3.4 of Form 8-A12B (File No. 000-50363), filed October 19, 2006.  |
| 3.1.4                 | Articles of Amendment to Articles of Amendment and Restatement to Articles of Incorporation, incorporated by reference to Exhibit 3.1.1 to the Quarterly Report on Form 10-Q, filed July 30, 2009.                                           |
| 3.1.5                 | Articles Supplementary, incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K, filed March 19, 2010.                                                                                                                    |
| 3.1.6                 | Articles Supplementary, incorporated by reference to Exhibit 3.1 of the Current Report on Form 8-K, filed September 9, 2010.                                                                                                                 |
| 3.1.7                 | Articles Supplementary, incorporated by reference to Exhibit 3.2 of the Current Report on Form 8-K, filed September 9, 2010.                                                                                                                 |
| 3.2                   | Bylaws, incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-11 (File No. 333-106024), filed June 11, 2003.                                                                                                      |
| 3.2.1                 | First Amendment to Bylaws, incorporated by reference to Exhibit 99.1 of the Current Report on Form 8-K, filed July 10, 2007.                                                                                                                 |
| 4.1                   | Form of Certificate for Common Stock of Gladstone Commercial Corporation, incorporated by reference to Exhibit 4.1 to the Registration Statement on Form S-11 (File No. 333-106024), filed August 8, 2003.                                   |
| 4.2                   | Form of Certificate for 7.75% Series A Cumulative Redeemable Preferred Stock of Gladstone Commercial Corporation, incorporated by reference to Exhibit 4.1 of Form 8-A12G (File No. 000-50363), filed January 19, 2006.                      |
| 4.3                   | Form of Certificate for 7.5% Series B Cumulative Redeemable Preferred Stock of Gladstone Commercial Corporation, incorporated by reference to Exhibit 4.2 of Form 8-A12B (File                                                               |

No. 001-33097), filed October 19, 2006.

- 10.1 Real Property Purchase and Sale Agreement (Canada) between 3058348 Nova Scotia Company, 3058349 Nova Scotia Company and Gladstone Commercial Limited Partnership, dated August 11, 2004, incorporated by reference to Exhibit 10.4 to the Form 10-K (File No. 000-50363), filed March 8, 2005

**Table of Contents**

| <b>Exhibit Number</b> | <b>Exhibit Description</b>                                                                                                                                                                                                                                                                                                                 |
|-----------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.2                  | Real Property Purchase and Sale Agreement (United States) between PBC Pocono, L.L.C., PBC Norfolk, L.L.C. and Gladstone Commercial Limited Partnership, dated August 11, 2004, incorporated by reference to Exhibit 10.5 to the Form 10-K (File No. 000-50363), filed March 8, 2005.                                                       |
| 10.3                  | Promissory Note between Key Bank National Association and CMI04 Canton NC LLC, dated March 14, 2005, incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 (File No. 000-50363), filed May 4, 2005.                                                                          |
| 10.4                  | Loan Agreement between AFL05 Duncan SC LLC and Little Arch Charlotte NC LLC and Bank of America, N.A., dated as of August 25, 2005, incorporated by reference to Exhibit 10.4 of the Current Report on Form 8-K (File No. 000-50363), filed August 29, 2005.                                                                               |
| 10.5                  | Promissory Note between AFL05 Duncan SC LLC and Little Arch Charlotte NC LLC and Bank of America, N.A., dated as of August 25, 2005, incorporated by reference to Exhibit 10.5 of the Current Report on Form 8-K (File No. 000-50363), filed August 29, 2005.                                                                              |
| 10.6                  | Mortgage and Security Agreement between 260 Springside Drive, Akron OH LLC and JP Morgan Chase Bank, N.A., dated as of September 12, 2005, incorporated by reference to Exhibit 10.6 of the Current Report on Form 8-K (File No. 000-50363), filed September 13, 2005.                                                                     |
| 10.7                  | Fixed Rate Note between 260 Springside Drive, Akron OH LLC and JP Morgan Chase Bank, N.A., dated as of September 12, 2005, incorporated by reference to Exhibit 10.7 of the Current Report on Form 8-K (File No. 000-50363), filed September 13, 2005.                                                                                     |
| 10.8                  | Loan Agreement between PZ05 Maple Heights OH LLC, WMI05 Columbus OH LLC, and OB Crenshaw GCC, LP, and Countrywide Commercial Real Estate Finance, Inc., dated as of December 21, 2005, incorporated by reference to Exhibit 10.8 of the Current Report on Form 8-K (File No. 000-50363), filed December 22, 2005.                          |
| 10.9                  | Promissory Note between PZ05 Maple Heights OH LLC, WMI05 Columbus OH LLC, and OB Crenshaw GCC, LP, and Countrywide Commercial Real Estate Finance, Inc., dated as of December 21, 2005, incorporated by reference to Exhibit 10.9 of the Current Report on Form 8-K (File No. 000-50363), filed December 22, 2005.                         |
| 10.10                 | First Amended and Restated Agreement of Limited Partnership of Gladstone Commercial Limited Partnership, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K, filed February 1, 2006.                                                                                                                              |
| 10.11                 | Mortgage and Absolute Assignment of Rents and Leases and Security Agreement (and Fixture Filing) between Stonewater Dox Funding LLC and Wells Fargo Bank, National Association, dated as of November 21, 2003, incorporated by reference to Exhibit 10.20 of the Current Report on Form 8-K (File No. 000-50363), filed February 24, 2006. |
| 10.12                 |                                                                                                                                                                                                                                                                                                                                            |

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Assumption Agreement between Stonewater Dox Funding LLC, Stonewater Funding, LLC, ACI06 Champaign IL LLC, Gladstone Commercial Corporation and LaSalle Bank National Association, dated as of February 21, 2006, incorporated by reference to Exhibit 10.21 of the Current Report on Form 8-K (File No. 000-50363), filed February 24, 2006.

- 10.13 Promissory Note Secured by Mortgage between Stonewater Dox Funding LLC and Wells Fargo Bank, National Association, dated as of November 21, 2003, incorporated by reference to Exhibit 10.22 of the Current Report on Form 8-K (File No. 000-50363), filed February 24, 2006.

**Table of Contents**

**Exhibit  
Number**

**Exhibit Description**

- |       |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|-------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.14 | Purchase Agreement between Stonewater UIS Funding LLC and Gladstone Commercial Limited Partnership, dated as of November 23, 2005, as the same has been modified by that certain Amendment to Purchase Agreement dated December 22, 2005, that certain Amendment to Purchase Agreement dated December 30, 2005, that certain Amendment to Purchase Agreement dated January 6, 2006, that certain Amendment to Purchase Agreement dated January 13, 2006, that certain Amendment to Purchase Agreement dated January 17, 2006 and that certain Amendment to Purchase Agreement dated January 20, 2006., incorporated by reference to Exhibit 10.23 of the Current Report on Form 8-K (File No. 000-50363), filed February 24, 2006. |
| 10.15 | Mortgage, Assignment of Rents and Security Agreement between Stonewater Funding LLC and Greenwich Capital Financial Products, Inc. dated as of May 12, 2004, incorporated by reference to Exhibit 10.24 of the Current Report on Form 8-K (File No. 000-50363), filed February 24, 2006.                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| 10.16 | Loan Assumption Agreement between Stonewater UIS Funding LLC, Stonewater Funding, LLC, and UC06 Roseville MN LLC, Gladstone Commercial Corporation and LaSalle Bank National Association, dated as of February 21, 2006, incorporated by reference to Exhibit 10.25 of the Current Report on Form 8-K (File No. 000-50363), filed February 24, 2006.                                                                                                                                                                                                                                                                                                                                                                               |
| 10.17 | Promissory Note between Stonewater UIS Funding LLC and Greenwich Capital Financial Products, Inc. dated as of May 12, 2004, incorporated by reference to Exhibit 10.26 of the Current Report on Form 8-K (File No. 000-50363), filed February 24, 2006.                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 10.18 | Purchase Agreement between Stonewater UIS Funding LLC and Gladstone Commercial Limited Partnership, dated as of November 23, 2005, as the same has been modified by that certain Amendment to Purchase Agreement dated December 22, 2005, that certain Amendment to Purchase Agreement dated December 30, 2005, that certain Amendment to Purchase Agreement dated January 6, 2006, that certain Amendment to Purchase Agreement dated January 13, 2006, that certain Amendment to Purchase Agreement dated January 17, 2006 and that certain Amendment to Purchase Agreement dated January 20, 2006, incorporated by reference to Exhibit 10.27 of the Current Report on Form 8-K (File No. 000-50363), filed February 24, 2006.  |
| 10.19 | Loan Agreement between IXIS Real Estate Capital Inc. and 2525 N Woodlawn Vstrm Wichita KS, LLC, CI05 Clintonville WI LLC and MSI05-3 LLC, dated as of April 27, 2006, incorporated by reference to Exhibit 10.29 of the Quarterly Report on Form 10-Q (File No. 000-50363), filed May 2, 2006.                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| 10.20 | Promissory Note between IXIS Real Estate Capital Inc. and 2525 N Woodlawn Vstrm Wichita KS, LLC, CI05 Clintonville WI LLC and MSI05-3 LLC, dated as of April 27, 2006, incorporated by reference to Exhibit 10.30 of the Quarterly Report on Form 10-Q (File No. 000-50363), filed May 2, 2006.                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| 10.21 | Custodial Service Agreement and Fee Schedule between Branch Banking and Trust Company of Virginia, and Gladstone Commercial Corporation, dated as of May 1, 2006, incorporated by                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |

reference to Exhibit 10.33 of the Quarterly Report on Form 10-Q (File No. 000-50363), filed August 8, 2006.

- 10.22 Gladstone Commercial Limited Partnership Schedule 4.2(a)(2) to First Amended and Restated Agreement of Limited Partnership Designation of 7.50% Series B Cumulative Redeemable Preferred Units, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K, filed October 25, 2006.

**Table of Contents**

| <b>Exhibit Number</b> | <b>Exhibit Description</b>                                                                                                                                                                                                                                                                                 |
|-----------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.23                 | Deed of Trust, Assignment of Leases and Rents and Security Agreement between First Park Ten COCO San Antonio, L.P. and CIBC Inc., dated as of November 22, 2006, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K (File No. 001-33097), filed November 28, 2006.                |
| 10.24                 | Deed of Trust, Assignment of Leases and Rents and Security Agreement between SLEE Grand Prairie, L.P. and CIBC Inc., dated as of November 22, 2006, incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K (File No. 001-33097), filed November 28, 2006.                             |
| 10.25                 | Deed of Trust, Assignment of Leases and Rents and Security Agreement between OB Midway NC Gladstone Commercial LLC, and CIBC Inc., dated as of November 22, 2006, incorporated by reference to Exhibit 10.3 of the Current Report on Form 8-K (File No. 001-33097), filed November 28, 2006.               |
| 10.26                 | Promissory Note First Park Ten COCO San Antonio, L.P., SLEE Grand Prairie, L.P. and OB Midway NC Gladstone Commercial LLC and CIBC Inc., dated as of November 22, 2006, incorporated by reference to Exhibit 10.4 of the Current Report on Form 8-K (File No. 001-33097), filed November 28, 2006.         |
| 10.27                 | Mortgage, Assignment of Leases and Rents and Security Agreement between HMBF05 Newburyport MA LLC and CIBC Inc., dated as of December 22, 2006, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K (File No. 001-33097), filed December 28, 2006.                                 |
| 10.28                 | Open-end Mortgage, Assignment of Leases and Rents and Security Agreement between SVMCM05 Toledo OH LLC and CIBC Inc., dated as of December 22, 2006, incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K (File No. 001-33097), filed December 28, 2006.                            |
| 10.29                 | Mortgage, Assignment of Leases and Rents and Security Agreement between TCI06 Burnsville MN LLC and CIBC Inc., dated as of December 22, 2006, incorporated by reference to Exhibit 10.3 of the Current Report on Form 8-K (File No. 001-33097), filed December 28, 2006.                                   |
| 10.30                 | Promissory Note between HMBF05 Newburyport MA LLC, SVMCM05 Toledo OH LLC and TCI06 Burnsville MN LLC and CIBC Inc., dated as of December 22, 2006, incorporated by reference to Exhibit 10.4 of the Current Report on Form 8-K (File No. 001-33097), filed December 28, 2006.                              |
| 10.31                 | Amended and Restated Investment Advisory Agreement between Gladstone Commercial Corporation and Gladstone Management Corporation, dated January 1, 2007 incorporated by reference to Exhibit 99.1 of the Current Report on Form 8-K (File No. 001-33097), filed January 3, 2007 (renewed on July 8, 2009). |
| 10.32                 |                                                                                                                                                                                                                                                                                                            |

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Administration Agreement between Gladstone Commercial Corporation and Gladstone Administration, LLC, dated January 1, 2007 incorporated by reference to Exhibit 99.2 of the Current Report on Form 8-K (File No. 001-33097), filed January 3, 2007 (renewed on July 8, 2009).

- 10.33 Open Market Sale Agreement by and among Gladstone Commercial Corporation, Gladstone Commercial Limited Partnership and Jefferies & Company, Inc., incorporated by reference to Exhibit 1.1 of the Form 8-K (File No. 001-33097), filed November 4, 2009.

**Table of Contents**

| <b>Exhibit Number</b> | <b>Exhibit Description</b>                                                                                                                                                                                                                                                                                                                                                                                      |
|-----------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.34                 | Amendment to First Amended and Restated Agreement of Limited Partnership of Gladstone Commercial Limited Partnership, incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K, filed April 29, 2010.                                                                                                                                                                                        |
| 10.35                 | Gladstone Commercial Limited Partnership Schedule 4.2(a)(3) to First Amended and Restated Agreement of Limited Partnership; Designation of Senior Common Units, incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K, filed April 29, 2010.                                                                                                                                              |
| 10.36                 | Amended and Restated Dealer Manager Agreement, dated December 22, 2009, by and between Gladstone Commercial Corporation and Halcyon Capital Markets, LLC, incorporated by reference to Exhibit 10.39 of the Annual Report on Form 10-K (File No. 001-33097), filed on February 24, 2010.                                                                                                                        |
| 10.37                 | Amended and Restated Dealer Manager Agreement, effective as of December 22, 2009, by and between Gladstone Commercial Corporation and Halcyon Capital Markets, LLC, incorporated by reference to Exhibit 10.40 of the Annual Report on Form 10-K (File No. 001-33097), filed on February 24, 2010.                                                                                                              |
| 10.38                 | Credit Agreement, dated as of December 28, 2010, by and among Gladstone Commercial Limited Partnership, Gladstone Commercial Corporation, each of the financial institutions initially a signatory thereto together with their successors and assignees under Section 12.6 thereof and Capital One, N.A., incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K, filed December 30, 2010. |
| 11                    | Computation of Per Share Earnings from Operations (included in the notes to the audited financial statements contained in this Report.                                                                                                                                                                                                                                                                          |
| 12                    | Statements re: computation of ratios (included in Selected Financial Data contained in this Form 10-K).                                                                                                                                                                                                                                                                                                         |
| 14                    | Gladstone Commercial Corporation Code of Business Conduct and Ethics, dated October 11, 2005, incorporated by reference to Exhibit 14.1 to Current Report on Form 8-K (File No. 000-50363), filed October 12, 2005.                                                                                                                                                                                             |
| 31.1                  | Certification of Chief Executive Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002 (filed herewith).                                                                                                                                                                                                                                                                                            |
| 31.2                  | Certification of Chief Financial Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002 (filed herewith).                                                                                                                                                                                                                                                                                            |
| 32.1                  | Certification of Chief Executive Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 (furnished herewith).                                                                                                                                                                                                                                                                                        |
| 32.2                  | Certification of Chief Financial Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002 (furnished herewith).                                                                                                                                                                                                                                                                                        |



**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

**Gladstone Commercial Corporation**

Date: March 8, 2011

By: /s/ Danielle Jones  
Danielle Jones  
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacity and on the dates indicated.

Date: March 8, 2011      By: /s/ David Gladstone

David Gladstone  
Chief Executive Officer and Chairman of the Board of  
Directors  
(principal executive officer)

Date: March 8, 2011      By: /s/ Terry Lee Brubaker

Terry Lee Brubaker  
Vice Chairman, Chief Operating Officer and Director

Date: March 8, 2011      By: /s/ George Stelljes III

George Stelljes III  
President, Chief Investment Officer and Director

Date: March 8, 2011      By: /s/ Danielle Jones

Danielle Jones  
Chief Financial Officer  
(principal financial and accounting officer)

Date: March 8, 2011      By: /s/ David A.R. Dullum

David A.R. Dullum  
Director

Date: March 8, 2011      By: /s/ Anthony W. Parker

Anthony W. Parker  
Director

Date: March 8, 2011      By: /s/ Michela A. English

Michela A. English  
Director

**Table of Contents**

Date: March 8, 2011      By: /s/ Paul Adelgren

Paul Adelgren  
Director

Date: March 8, 2011      By: /s/ John Outland

John Outland  
Director

Date: March 8, 2011      By: /s/ Gerard Mead

Gerard Mead  
Director

Date: March 8, 2011      By: /s/ John Reilly

John Reilly  
Director