

GLADSTONE COMMERCIAL CORP  
Form 10-K  
February 18, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

**FORM 10-K**

(Mark One)

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

**For the fiscal year ended December 31, 2014**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 001-33097**

**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 100**

**McLean, Virginia**  
**(Address of principal executive offices)**  
**(703) 287-5800**

**22102**  
**(Zip Code)**

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

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

| <b>(Title of each Class)</b>   | <b>(Name of each exchange on which registered)</b> |
|--|--|
| <b>Common Stock, \$0.001 par value per share</b>   | <b>NASDAQ Global Select Market</b>                 |
| <b>7.75% Series A Cumulative Redeemable Preferred Stock,<br/>par value \$0.001 per share</b> | <b>NASDAQ Global Select Market</b>                 |
| <b>7.50% Series B Cumulative Redeemable Preferred Stock,<br/>par value \$0.001 per share</b> | <b>NASDAQ Global Select Market</b>                 |
| <b>7.125% Series C Cumulative Term Preferred Stock, par<br/>value \$0.001 per share</b>      | <b>NASDAQ Global Select Market</b>                 |

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES  NO

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

Indicate by check mark whether the registrant has submitted electronically 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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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 Form 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  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12 b-2 of the Act). YES  NO .

The aggregate market value of the voting common stock held by non-affiliates of the Registrant on June 30, 2014, based on the closing price on that date of \$17.87 on the NASDAQ Global Select Market, was \$307,467,128. For the purposes of calculating this amount only, all directors and executive officers of the Registrant have been treated as affiliates. There were 20,359,081 shares of the Registrant's common stock, \$0.001 par value per share, outstanding as of February 18, 2015.

Documents Incorporated by Reference: Portions of the Registrant's Proxy Statement, to be filed no later than April 30, 2015, relating to the Registrant's 2015 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, 2014**

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**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. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and include this statement for purposes of complying with these safe harbor provisions. Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends concerning matters that are not historical facts. 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, may and va these words and similar expressions are intended to identify forward-looking statements, though not all forward-looking statements contain these words. 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:

re-leasing efforts;

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 Line of Credit (as defined herein), mortgage notes payable, future stock offerings 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 not to 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:

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

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failure to qualify as a real estate investment trust, or REIT, and in the risk of changing laws that affect REITs;

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, including other real estate investment companies;

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

our Adviser's ability to identify, hire and retain highly-qualified personnel;

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;

environmental uncertainties and risks related to natural disasters; and

the loss of any of our key officers, such as Mr. David Gladstone, our chairman and chief executive officer, Mr. Terry Lee Brubaker, our vice chairman and chief operating officer, or Mr. Robert Cutlip, our president.

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 have a material adverse affect on our business.

**Item 1. Business.**

**Overview**

Gladstone Commercial Corporation (which we refer to as we, us, or the Company ) is a 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, commercial and retail real

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property and selectively making long-term industrial and commercial mortgage loans. Our portfolio of real estate 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. As we have in the past, we intend 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. As of February 18, 2015, we owned a total of 96 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 GCLP Business Trust I, a Massachusetts business trust, which currently holds all of the limited partnership units of our Operating Partnership. 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 generally be entitled to redeem these units for cash or, at our election, shares of our common stock on a one-for-one basis.

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 any real estate mortgage loans.

Our business is managed by our external adviser, Gladstone Management Corporation, or our Adviser. Gladstone Administration, LLC, or our Administrator, provides administrative services to us. Both our Adviser and our Administrator are affiliates of ours and each other.

## **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 monthly cash distributions to our stockholders. Our primary strategy to achieve our investment objectives is to invest in and own a diversified portfolio of leased industrial, commercial and retail real estate that we believe will produce stable cash flow and increase in value. We may sell some of our real estate assets 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, industrial or retail real estate, which loans may have some form of equity participation. We currently have one mortgage loan outstanding.

We use leverage 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, although we have certain portfolio-level leverage covenants we must comply with under the terms of our unsecured line of credit, or the Line of Credit. 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. The market for long-term mortgages continues to improve as they become more obtainable and the environment is competitive. The collateralized mortgage backed securities, or CMBS, market remains active but it is more conservative and restrictive than it was prior to the recent recession and uncertainty with regard to interest rates has made the CMBS market less predictable. Consequently, we continue to look to regional banks, insurance companies and other non-bank lenders, in addition to the CMBS market, to issue mortgages to finance our real estate activities.

In addition to leverage, we were active in the equity markets during 2014 by issuing shares of common stock in one follow-on public offering, issuing shares under our at-the-market programs, or ATM Programs, pursuant to our former

open market sale agreement with Jefferies, LLC, or Jefferies, and our current agreement with Cantor Fitzgerald & Co., or Cantor Fitzgerald, and also issuing shares of our convertible senior common stock.

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### **Investment Policies**

#### ***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 a majority of our investments will be continue to be structured as net leases, but if a net lease would have an adverse impact on a potential tenant, or we assume a lease with a different existing structure in place, we may structure our investment as either a gross, or modified gross lease or as a mortgage loan. Investments are not restricted to geographical areas, but we expect that most of our investments in real estate will continue to 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 and instead rely on the advice of our Adviser. See *Risk Factors 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.*

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 or Gladstone Commercial Lending. We have not issued any limited partnership units to date.

##### *Property Acquisitions and Net Leasing*

To date, we have purchased a majority of our properties 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 by purchasing one or more properties from the tenant and by leasing it on a net basis 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 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.*

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 continue to acquire 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.

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### *Investments in Mortgage Loans*

Although we expect to make investments in mortgage loans 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 or would otherwise be inappropriate for us. We anticipate that most of our lending transactions would be loans secured by industrial or commercial property or issued in connection with a build-to-suit transaction. 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 provided that such transactions are otherwise 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. We currently have one mortgage loan outstanding.

### *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 evaluating a prospective 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 one of the most important aspects 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 the tenants rating by a national credit rating agency, if any, management experience, industry position and fundamentals, operating history and capital structure. Currently, 34% of our tenants are rated by a national credit rating agency. 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 improves, 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.



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*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 of our 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 of a single under-performing investment or a downturn in any particular industry or geographic region. Please see Item 2 of this Form 10-K for a summary of our portfolio by industry and geographic location.

*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 tenant. Our Adviser evaluates the financial capability of the tenant and its ability to perform per the terms of the lease, including obtaining certificates of insurance and verifying payment of real estate taxes on an annual basis. Our Adviser may also examine the available operating results of prospective investment properties to determine whether or not projected rental levels are likely to be met. As further described below, our Advisor also evaluates the physical characteristics of a prospective property investment and comparable properties as well as the geographic location of the property in the particular market to ensure that the characteristics are favorable for re-leasing the property at approximately the same or higher rental rate should that necessity arise. Our Adviser then computes the value of the property based on historical and projected operating results. In addition, each property that we propose to purchase is appraised by an independent appraiser. These appraisals may take into consideration, among other things, the terms and conditions of the particular lease transaction and the conditions of the credit markets at the time the purchase is negotiated. We generally limit the purchase price of each acquisition to less than 10% of our consolidated total assets.

*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 files bankruptcy, as leases on properties essential or important to the operations of a bankrupt tenant are typically less likely to be rejected in 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, 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. Our Adviser generally also seeks 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.

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### *Underwriting of the Real Estate and Due Diligence Process*

In addition to underwriting the tenant or borrower, our Adviser also underwrites 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 compliance 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. We could incur significant costs related to government regulation and private litigation over environmental matters. See *Risk Factors We could be exposed to liability and remedial costs related to environmental matters.*

Our Adviser also reviews the structural soundness of the improvements on the property and may engage a structural engineer to review multiple aspects of the structures 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 structure and configuration, 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 its value. All of our Adviser's due diligence is aimed at arriving at a valuation of the real estate under the assumption that it would not be rented to the existing tenant. 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.

An assessment of the relative flexibility of the building configuration and its ability to be re-leased to other users in a single or multiple tenant arrangement.

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 at current construction prices 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 an independent 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.

*Use of Leverage*

We use long-term mortgage borrowings as a financing mechanism in amounts that we believe will maximize the return to our stockholders. Currently, the majority 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

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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 its satisfaction. 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 consequently, there may be circumstances where lenders have recourse to our other assets. To a much lesser extent, we use recourse financing. Of the \$459.3 million in long-term mortgages outstanding as of December 31, 2014, only \$2.0 million is recourse to the Company.

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.

## **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 independent directors, we will not:

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

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

engage in any other transaction with any of our directors, officers or our Adviser's employees, or any entity in which any of our directors, officers or our Adviser's 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, Gladstone Land 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.

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### *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.

### **Code of Ethics**

The Company and its affiliates, including Gladstone Capital Corporation, Gladstone Investment Corporation, Gladstone Land Corporation, Gladstone Management Corporation, Gladstone Administration, LLC, and Gladstone Securities, LLC have adopted a code of ethics and business conduct applicable to all personnel of such companies that complies with the guidelines set forth in Item 406 of Regulation S-K of the Securities Act of 1933, as amended. This code establishes procedures for personal investments, restricts certain transactions by such personnel and requires the reporting of certain transactions and holdings by such personnel. A copy of this code is available for review, free of charge, at our website at [www.GladstoneCommercial.com](http://www.GladstoneCommercial.com). We intend to provide any required disclosure of any amendments to or waivers of the provisions of this code by posting information regarding any such amendment or waiver to our website within four days of its effectiveness.

### **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, and investing in real estate and making mortgage loans. We have entered into an investment advisory agreement with our Adviser, or the Advisory Agreement, 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. Gladstone Administration, LLC, or our Administrator, employs our chief financial officer, treasurer, chief compliance officer, general counsel (who also serves as our Administrator's president) and secretary and their respective staffs and provides administrative services for us under the Administration Agreement.

David Gladstone, our chairman and chief executive officer, is also the chairman, chief executive officer and the controlling stockholder of our Adviser and our Administrator. Terry Lee Brubaker, our vice chairman and chief operating officer and a member of our Board of Directors, also serves in the same capacities for our Adviser and our Administrator. Robert Cutlip, our president, is also an executive managing director of our Adviser.

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

Our Adviser's board of directors has empowered our 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

investment committee to ensure that, in its view, the proposed transaction satisfies our investment criteria and is within our investment policies. Approval by our investment committee is generally the final step in the property acquisition approval process, although the separate

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approval of our Board of Directors is required in certain circumstances described below. For further detail on this process, please see *Investment Policies Underwriting Criteria, Due Diligence Process and Negotiating Lease Provisions*.

Our Adviser and Administrator are headquartered in McLean, Virginia, a suburb of Washington, D.C., and our Adviser also has offices in several other states.

### ***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, respectively.

#### ***Advisory 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, 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 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).

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 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; however, our Adviser may earn fee income from our borrowers, tenants or other sources.

For purposes of calculating the incentive fee, FFO includes any realized capital gains and capital losses, less any distributions paid on preferred stock and convertible 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 quarterly 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).



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*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 100% of FFO with acquisition-related costs that are required to be expensed under Accounting Standards Codification, or ASC 805, Business Combinations, added back to FFO.

*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, treasurer, chief compliance officer, general counsel and secretary (who also serves as our Administrator's president), and their respective staffs. Prior to July 1, 2014, our allocable portion was generally derived by multiplying that portion of the Administrator's expenses allocable to all funds managed by the Adviser by the percentage of our total assets at the beginning of each quarter in comparison to the total assets of all funds managed by the Adviser. As approved by our Board of Directors, effective July 1, 2014, our allocable portion of the Administrator's expenses are generally derived by multiplying our Administrator's total expenses by the approximate percentage of time the Administrator's employees perform services for us in relation to their time spent performing services for all companies serviced by our Administrator under contractual agreements. Management believes that the new methodology of allocating the Administrator's total expenses by approximate percentage of time services were performed among all companies serviced by our Administrator more closely approximates fees paid to actual services performed.

*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.

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Our Board of Directors has authorized our Adviser to make investments in any property on our behalf without the prior approval of our Board of Directors 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.

The actual terms and conditions of transactions involving investments in properties and mortgage loans are determined at 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 or other affiliates (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 or administrator, respectively, to Gladstone Capital Corporation and Gladstone Investment Corporation, both publicly traded business development companies affiliated with us, and Gladstone Land Corporation, a publicly traded agricultural real estate company that is also our affiliate. 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.

## **Gladstone Securities**

Gladstone Securities, LLC, or Gladstone Securities, is a privately held broker dealer registered with the Financial Industry Regulatory Authority and insured by the Securities Investor Protection Corporation. Gladstone Securities is an affiliate of ours, as its parent company is controlled by Mr. David Gladstone, our chairman and chief executive officer. Mr. Gladstone also serves on the board of managers of Gladstone Securities.

***Dealer Manager Agreement***

In connection with the offering of our convertible senior common stock, or Senior Common Stock, we entered into a Dealer Manager Agreement, dated March 25, 2011, or the Dealer Manager Agreement, with Gladstone Securities, or the Dealer Manager, pursuant to which the Dealer Manager agreed to act as our exclusive dealer manager in connection with the offering. Pursuant to the terms of the Dealer Manager Agreement, the Dealer Manager is entitled to receive a sales commission in the amount of 7.0% of the gross proceeds of the shares of Senior Common Stock sold, plus a dealer manager fee in the amount of 3.0% of the gross proceeds of the shares of Senior Common Stock sold. Gladstone Securities, in its sole and absolute discretion, may re-allocate all of its selling commissions attributable to a participating broker-dealer and may also re-allocate a portion of its dealer manager fee earned in respect of the proceeds

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generated by the participating broker-dealer to any participating broker-dealer as a non-accountable marketing allowance. In addition, we have agreed to indemnify the Dealer Manager against various liabilities, including certain liabilities arising under the federal securities laws. We made payments of approximately \$0.6 million and \$0.3 million during the years ended December 31, 2014 and 2013, respectively, to Gladstone Securities pursuant to this agreement, which are reflected as a component of Senior Common Stock costs in the statement of stockholders' equity. The Dealer Manager Agreement is scheduled to terminate on the earlier of (i) March 28, 2015 or (ii) the date on which 3,000,000 shares of Senior Common Stock are sold pursuant to the Dealer Manager Agreement. We have elected not to renew the program upon termination on March 28, 2015, and thus the Dealer Manager Agreement will simultaneously terminate on March 28, 2015.

***Mortgage Financing Arrangement Agreement***

We also entered into an agreement with Gladstone Securities, effective June 18, 2013, for it to act as our non-exclusive agent to assist us with arranging mortgage financing for properties we own. In connection with this engagement, Gladstone Securities may from time to time solicit the interest of various commercial real estate lenders or recommend to us third party lenders offering credit products or packages that are responsive to our needs. We pay Gladstone Securities a financing fee in connection with the services it provides to us for securing mortgage financing on any of our properties. The amount of these financing fees, which are payable upon closing of the financing, will be based on a percentage of the amount of the mortgage, generally ranging from 0.15% to a maximum of 1.0% of the mortgage obtained. The amount of the financing fees may be reduced or eliminated, as determined by us and Gladstone Securities, after taking into consideration various factors, including, but not limited to, the involvement of any third party brokers and market conditions. We paid financing fees to Gladstone Securities of \$0.1 million for each of the years ended December 31, 2014 and 2013, respectively, on total mortgages secured of \$52.1 million and \$76.3 million, or 0.27% and 0.18%, respectively. The agreement is scheduled to terminate on August 31, 2015, unless renewed or earlier terminated.

**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 a total of 15 to 20 full time employees of our Adviser and our Administrator will spend substantial time on our matters during calendar year 2015. 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, 2014, our Adviser and Administrator collectively had 61 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>  |
|------------------------------|---|
| 11                           | Executive Management  |
| 36                           | Investment Management, Portfolio Management and Due Diligence |
| 14                           |   |

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 business of investing in and owning leased industrial, commercial and retail real property are the quality of

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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.

**Available Information**

Copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and amendments, if any, to those reports filed or furnished with the Securities and Exchange Commission, or SEC, pursuant to Section 13(a) or 15(d) of the Securities Exchange Act are available free of charge through our website at [www.GladstoneCommercial.com](http://www.GladstoneCommercial.com). A request for any of these reports may also be submitted to us by sending a written request addressed to Investor Relations, Gladstone Commercial Corporation, 1521 Westbranch Drive, Suite 100, McLean, VA 22102, or by calling our toll-free investor relations line at 1-866-366-5745. The public may read and copy materials that we file with the SEC 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 a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at [www.sec.gov](http://www.sec.gov).

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**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.*

***Risks related to our business 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 recent recession. 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 reasonable 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.

*We are subject to the credit risk of our tenants, which in the event of bankruptcy, could adversely affect our results of operations.*

We are subject to the credit risk of our tenants. Any 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 lease) 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.

In addition, we may enter into in 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

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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 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.

*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 to other tenants at rates equal to or above the current market 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. We may be required to expend substantial funds for tenant improvements and tenant refurbishments to re-lease the vacated space and cannot assure you that we will have sufficient sources of funding available to use in the future for such purposes and therefore may have difficulty in securing a replacement tenant. Any of these factors could adversely impact our financial condition, results of operations, cash flow or our ability to pay distributions to our stockholders.

*Net leases may not result in fair market lease rates over time, thereby failing to maximize income and distributions to our stockholders.*

A large portion of our rental income comes from triple net leases, which 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, triple 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 triple net leases.

*Multi-tenant properties expose us to additional risks.*

Our multi-tenant properties could expose us to the risk that a sufficient number of suitable tenants may not be found to enable the property to operate profitably. This loss of income could cause a material adverse impact to our results of operations and business. Multi-tenant properties are also subject to tenant turnover and fluctuation in occupancy rates, which could affect our operating results. Furthermore, multi-tenant properties expose us to the risk of increased operating expenses, which may occur when the actual cost of taxes, insurance and maintenance at the property exceeds the operating expenses paid by tenants and/or the amounts budgeted.

*We face certain risks associated with our build-to-suit activities.*

We may (1) provide a developer with either a combination of financing for construction of a build-to-suit property or a commitment to acquire a property upon completion of construction of a build-to-suit property and commencement of rent from the tenant or (2) acquire a property subject to a lease and engage a developer to complete construction of

a build-to-suit property as required by the lease. We face uncertainties associated with a developer's timely performance and timely completion of a project, including the performance or timely completion of contractors and subcontractors. If a developer, contractor or subcontractor fails to perform, we may resort to legal action to compel performance, remove the developer or rescind the purchase or construction contract.

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We may incur additional risks as we make periodic payments or other advances to developers before completion of construction. These and other factors can result in increased costs of a project or loss of our investment, and may be affected by conditions beyond both our and the developer's control.

*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 our stockholders.*

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, industrial and retail 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.

*Many of our tenants are small and medium sized 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 may be 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 because its financial resources may be more limited.*

*Small and medium-sized businesses typically have narrower product lines and smaller market shares than large businesses.* Because our target tenants and borrowers are typically smaller businesses that may have narrower product lines and smaller market share, they may be more vulnerable to competitors' actions and market conditions, as well as general economic downturns.

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*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.*

*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.*

*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, 2014, we owned 96 properties and had 91 tenants in these properties, and our 5 largest tenants accounted for approximately 18.0% of our total rental income. A consequence of a limited number of tenants is that the aggregate returns we realize may be materially 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, 2014, 17.7% of our total rental income was earned from tenants in the telecommunications industry, 12.2% was earned from tenants in the healthcare industry, and 12.1% was earned from tenants in the automobile 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.

*Healthcare reform legislation may affect our results of operations and financial condition.*

In 2010, the President of the United States signed into law the Patient Protection and Affordable Care Act of 2010 and the Health Care and Education Reconciliation Act, which in part modified the Patient Protection and Affordable Care Act (collectively the Acts). Together, the Acts serve as the primary vehicle for comprehensive health care reform in the U.S. and are intended to reduce the number of individuals in the U.S. without health insurance and effect significant other changes to the ways in which health care is organized, delivered and reimbursed. The complexities and ramifications of the new legislation are significant, and have begun being implemented through a phased approach that will conclude in 2018. At this time, the effects of health care reform and its impact on our tenants' business, results of operations and financial condition and the resulting impact on our operations cannot be determined. The Acts could adversely affect the financial and operational performance of our tenants in the healthcare industry specifically and increase the cost of providing healthcare coverage for all tenants generally and could adversely affect the financial and operational performance of our tenants and their results of operations. This may result in a decreased ability of our tenants to make lease payments, and thereby adversely affect our liquidity, financial condition, results of operations and ability to pay distributions to our stockholders.



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*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 each investment 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 would be 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.

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

Losses from disaster-type occurrences (such as wars, floods or earthquakes) may be either uninsurable or not insurable on economically viable terms. Should such a 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, 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

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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.

The assessments we perform on our acquisition of property may fail 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.

*Our properties may be subject to impairment charges, which could adversely affect our results of operations.*

We are required to periodically evaluate our properties for impairment indicators. A property's value is considered impaired if management's estimate of the aggregate future cash flows (undiscounted and without interest charges) to be generated by the property, based upon its intended use, is less than the carrying value of the property. These estimates of cash flows are based upon factors such as expected future operating income, trends and prospects, as well as the effects of interest and capitalization rates, demand and occupancy, competition and other factors. These factors may result in uncertainty in valuation estimates and instability in the estimated value of our properties which, in turn, could result in a substantial decrease in the value of the properties and significant impairment charges.

We continually assess our properties to determine if any impairments are necessary or appropriate. No assurance can be given that we will be able to recover the current carrying amount of our properties in the future. Our failure to do so would require us to recognize additional impairment charges for the period in which we reached that conclusion, which could materially and adversely affect us and our results of operations.

*Mortgage loans 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.*

Investments in mortgage loans, exposes us to the risk of default 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. 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. We currently have one mortgage loan outstanding.



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***Risks related to our financing***

*Capital markets and economic conditions can materially affect our financial condition and results of operations, the value of our equity securities, and our ability to sustain payment of our distribution at current levels.*

Many factors affect the value of our equity securities and our ability to make or maintain at current levels distributions to the holders of our shares of beneficial interest, including the state of the capital markets and the economy, which in recent years have negatively affected substantially all businesses, including ours. Demand for office, industrial, and retail space nationwide has slowly improved, it is approaching pre-recession levels. The availability of credit has been and may in the future again be adversely affected by illiquid credit markets. Regulatory pressures and the burden of troubled and uncollectible loans led some lenders and institutional investors to reduce, and in some cases, cease to provide funding to borrowers. If these market conditions recur, they may limit our ability and the ability of our tenants to timely refinance maturing liabilities and access the capital markets to meet liquidity needs, which may materially affect our financial condition and results of operations and the value of our equity securities and our ability to sustain payment of our distribution at current levels.

*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 100% of our FFO. As of December 31, 2014, 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. 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, as a result we may be negatively affected by restrictions on additional borrowings, and the risks associated with leverage, including our debt service obligations.*

We use 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.



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*We face risks related to balloon payments and refinancing.*

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 have balloon payments of \$34.6 million payable during fiscal year 2015.

*We mortgage our properties, which subjects us to the risk of foreclosure in the event of non-payment.*

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. We look to regional banks, insurance companies and other non-bank lenders, and, to a lesser extent, the CMBS market to issue mortgages to finance our real estate activities. For the year ended December 31, 2014, we had obtained or assumed approximately \$62.2 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.

*We face a risk from the fact that certain of our properties are cross-collateralized.*

As of December 31, 2014, the mortgages on certain of our properties were cross-collateralized. To the extent that any of the properties in which we have an interest are cross-collateralized, any default by the property owner subsidiary under the mortgage note relating to the one property will result in a default under the financing arrangements relating to any other property that also provides security for that mortgage note or is cross-collateralized with such mortgage note.

*A change in the value of our assets could cause us to experience a cash shortfall or be in default of our loan covenants.*

We borrow on an unsecured basis under the Line of Credit. A significant reduction in the value of our pool of unencumbered assets could require us to pay down the balance of the 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 Line of Credit, this inability could have a material adverse effect on our liquidity and our ability to meet our loan covenants.

*Interest rate fluctuations 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 Line of Credit and one of our long-term mortgages is variable. Although we seek to mitigate this risk by structuring such provisions to contain a minimum interest rate or escalation rate, as applicable, these features do not eliminate this risk. We are also exposed to the effects of interest rate changes as a result of holding cash and cash equivalents in short-term, interest-bearing investments. We have entered into an interest rate cap to attempt to manage our exposure to interest rate fluctuations on our only outstanding variable rate mortgage. A significant change in interest rates could have an adverse impact on our results of operations.



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### ***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 industrial, commercial and retail property. 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 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.

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

We compete with many other entities to acquire properties, including financial institutions, institutional pension funds, other REITs, foreign real estate investors, other public and private real estate companies and private real estate investors. These competitors may prevent us from acquiring desirable properties, cause an increase in the price we must pay for real estate, 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 three 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, thus 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 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.

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***Risks related to our Adviser***

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

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 Robert Cutlip, our president. The departure of any of our executive officers or key personnel 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, or Gladstone Capital, Gladstone Investment Corporation, or Gladstone Investment, and Gladstone Land Corporation, or Gladstone Land. Moreover, with the exception of our chief financial officer, and president, all of our executive officers and directors are also executive officers and directors of Gladstone Capital and Gladstone Investment, which actively make loans to and invest in small and medium-sized companies. In addition, with the exception of our president, all of our executive officers and eight of our nine directors are also executive officers and directors of Gladstone Land. 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, Gladstone Investment and Gladstone Land, 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

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.

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*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 FFO. 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 a voluntary, unconditional and irrevocable waiver. For the years ended December 31, 2014, 2013 and 2012, an unconditional and irrevocable voluntary waiver was issued by our Adviser for approximately \$3.0 million, \$3.5 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 distributions to stockholders would be adversely impacted.*

We intend to continue to be organized and to operate to qualify as a REIT under the Internal Revenue Code of 1986, as amended, or 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 distributions to stockholders would be reduced; and

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

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*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 distributions 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 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. In order to meet the 90% distribution requirement and to avoid the 4% excise tax, we may need to incur additional borrowings. Although we intend to pay distributions 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 the 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 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 taxable REIT subsidiary, or TRS) and qualified real estate assets) generally cannot include more than 10% of the outstanding voting 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 distributions, 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.

*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 share of our stock. If our distributions result in a

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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.

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

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.

*Complying with the 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 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.

*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 our Operating Partnership 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 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.

## ***Other risks***

*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.

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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.

*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. 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, but are not limited to:

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.

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*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.

*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 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 our investment and financing policies, growth strategy and our 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.

*Our failure to redeem our Series C Term Preferred Stock on its mandatory redemption date could trigger a change of control in our Board of Directors.*

If we fail to redeem or call for redemption the Series C Term Preferred Stock pursuant to the mandatory redemption required on January 31, 2017, the number of directors constituting our Board of Directors will be increased by the minimum number of directors, that when added to our Board of Directors, will constitute a majority, and the holders of our Series C Term Preferred Stock will be entitled, voting as a separate class (to the exclusion of the holders of all other classes or series of our stock), to elect such number of additional directors. Therefore, a change of control in our Board of Directors could occur, which could jeopardize the stability of our Company.

*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 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.

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*Our ability to pay dividends is limited by the requirements of Maryland law.*

Our ability to pay dividends on our stock is limited by the laws of Maryland. Under applicable Maryland law, a Maryland corporation generally may not make a distribution if, after giving effect to the distribution, the corporation would not be able to pay its debts as the debts become due in the usual course of business or the corporation's total assets would be less than the sum of its total liabilities plus, unless the corporation's charter permits otherwise, the amount that would be needed, if the corporation were dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of stockholders whose preferential rights are superior to those receiving the distribution. Accordingly, we generally may not make a distribution on our stock if, after giving effect to the distribution, we would not be able to pay our debts as they become due in the usual course of business or our total assets would be less than the sum of our total liabilities plus, unless the terms of such class or series provide otherwise, the amount that would be needed to satisfy the preferential rights upon dissolution of the holders of shares of any class or series of stock then outstanding, if any, with preferences upon dissolution senior to those of such class of stock with respect to which the distribution would be made.

**Item 1B. Unresolved Staff Comments.**

None.

**Table of Contents****Item 2. Properties.**

The following table provides certain summary information about our 96 wholly-owned, properties as of December 31, 2014 (dollars in thousands, except per square foot information).

| Property   | Year Built/<br>Improvements | Date of Purchase | Rentable<br>Square Footage | Occupancy | Lease<br>Expiration | Total Rental Income for<br>the<br>Year ended<br>of December 31, per<br>2014 Occupied Square<br>(4) Foot | Total Rental<br>Income | Encumbrances |
|--|-----------------------------|------------------|----------------------------|-----------|---------------------|---|------------------------|--------------|
| 208 South Rogers<br>Lane<br><br>(Raleigh NC)                     | 1997                        | 12/23/2003       | 58,926                     | 100%      | 2015                | \$ 624  | \$ 10.59               | \$ 4,796     |
| 3874 Highland<br>Park NW<br><br>(Canton, OH)                     | 1994                        | 1/30/2004        | 54,018                     | 100%      | 2024                | 283   | 5.24                   | 2,664        |
| 260 Springside<br>Drive<br><br>(Akron, OH) (1)                   | 1968/1999                   | 4/29/2004        | 83,891                     | 100%      | 2020                | 917   | 10.93                  | 6,828        |
| 5815 Westpark<br>Drive<br><br>(Charlotte, NC)                    | 1984/1995                   | 6/30/2004        | 64,500                     | 100%      | 2019                | 1,091   | 16.91                  | 6,308        |
| 171 Great Oak<br>Drive<br><br>(Canton, NC)                       | 1998/2014                   | 7/6/2004         | 365,960                    | 100%      | 2034                | 984   | 2.69                   | 3,652        |
| Rt. 219, Tax<br>Parcel<br>No. 33-251-0246,<br><br>(Crenshaw, PA) | 1991                        | 8/5/2004         | 290,000                    | 100%      | 2026                | 717   | 2.47                   | 5,176        |
| 9698 Old US<br>Hwy. 52<br><br>(Lexington, NC)                    | 1986                        | 8/5/2004         | 154,000                    | 100%      | 2026                | 381   | 2.47                   | 2,636        |
| 9100 Highway<br>290 East<br><br>(Austin, TX)                     | 2001                        | 9/16/2004        | 51,933                     | 100%      | 2022                | 705   | 13.58                  | 6,500        |
| 13 Industrial Park<br>Drive                                      | 1995/1999                   | 10/15/2004       | 223,275                    | 100%      | 2021                | 633   | 2.84                   | 4,889        |

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|   |                |                      |                  |              |              |            |              |            |  |
|---|----------------|----------------------|------------------|--------------|--------------|------------|--------------|------------|--|
| (Mt. Pocono, PA)<br>6550 First Park<br>Ten Boulevard        |                |                      |                  |              |              |            |              |            |  |
| (San Antonio, TX)<br>4630 Journal<br>Street                 | 1999           | 2/10/2005            | 60,245           | 100%         | 2021         | 782        | 12.98        | 6,643      |  |
| (Columbus, OH)<br>199 Sing Sing<br>Road                     | 1995           | 2/10/2005            | 39,000           | 100%         | 2015         | 308        | 7.90         | 2,516      |  |
| (Big Flats, NY)<br>2525 North<br>Woodlawn<br>Avenue         | 2001           | 4/15/2005            | 120,000          | 100%         | 2023         | 494        | 4.12         | 5,365      |  |
| (Wichita, KS)<br>725 & 737 Great<br>Southwest Pkwy          | 2000           | 5/18/2005            | 69,287           | 100%         | 2017         | 780        | 11.26        | 7,466      |  |
| (Arlington, TX)<br>4032 Linden<br>Avenue                    | 1966           | 5/26/2005            | 64,000           | 100%         | 2018         | 693        | 10.83        | 3,814      |  |
| (Dayton, OH)<br>81 Corbett Way                              | 1956           | 6/30/2005            | 59,894           | 100%         | 2015         | 268        | 4.47         | 1,877      |  |
| (Eatontown, NJ)<br>17 & 20 Veronica<br>Avenue               | 1991           | 7/7/2005             | 30,268           | 100%         | 2024         | 537        | 17.74        | 4,365      |  |
| (Franklin<br>Township, NJ)<br>150 Ridgeview<br>Center Drive | 1978           | 7/11/2005            | 183,000          | 100%         | 2020         | 988        | 5.40         | 6,471      |  |
| (Duncan, SC)<br>170 Ridgeview<br>Center Drive               | 1984/2001/2007 | 7/14/2005            | 222,670          | 100%         | 2020         | 1,539      | 6.91         | 10,375     |  |
| (Duncan, SC)<br>5656 Campus<br>Parkway                      | 1984/2001/2007 | 7/14/2005            | 55,350           | 100%         | 2020         | 383        | 6.92         | 2,579      |  |
| (Hazelwood, MO)<br>914 Wohlert Street                       | 1977           | 8/5/2005             | 51,155           | 100%         | 2023         | 213        | 4.16         | 2,291      |  |
| (Angola, IN)<br>800 Growth<br>Parkway                       | 1982<br>1998   | 9/2/2005<br>9/2/2005 | 52,080<br>50,000 | 100%<br>100% | 2023<br>2023 | 127<br>127 | 2.44<br>2.54 | 626<br>601 |  |

|   |           |            |         |      |      |       |       |       |  |
|---|-----------|------------|---------|------|------|-------|-------|-------|--|
| (Angola, IN)<br>802 East 11th<br>Street   |           |            |         |      |      |       |       |       |  |
| (Rock Falls, IL)<br>2 Opportunity<br>Way  | 1988      | 9/2/2005   | 52,000  | 100% | 2023 | 127   | 2.44  | 626   |  |
| (Newburyport,<br>MA)<br>255 Spring Street | 1994      | 10/17/2005 | 86,308  | 100% | 2015 | 891   | 10.32 | 6,276 |  |
| (Clintonville, WI)<br>5700 Lee Road       | 1992/2013 | 10/31/2005 | 521,400 | 100% | 2028 | 961   | 1.84  | 2,997 |  |
| (Maple Heights,<br>OH)                    | 1974      | 12/21/2005 | 347,218 | 100% | 2015 | 1,278 | 3.68  | 9,790 |  |

**Table of Contents****Item 2. Properties (Continued)**

| Property  | Year Built/<br>Improvement | Date of Purchase | Rentable<br>Square Feet | Occupancy | Lease<br>Expiration | Total Rental Income<br>Year of ended<br>December 31, 2014 <sup>(4)</sup> | Total Rental<br>Income<br>per<br>Occupied Square<br>Foot | Encumbrances |
|---|----------------------------|------------------|-------------------------|-----------|---------------------|--|--|--------------|
| 7545 Midlothian<br>Turnpike<br><br>(Richmond, VA)       | 1972                       | 12/30/2005       | 42,213                  | 100%      | 2017                | \$ 68  | \$ 5.10 <sup>(2)</sup>                                   | \$ 5,275     |
| 3930 Sunforest<br>Court<br><br>(Toledo, OH)             | 1979                       | 12/30/2005       | 23,368                  | 100%      | 2020                | 276  | 11.81  | 2,750        |
| 75 Canal Street<br><br>(South Hadley,<br>MA)            | 1978                       | 2/15/2006        | 150,000                 | 100%      | 2017                | 269  | 1.79   |              |
| 2101 Fox Drive<br><br>(Champaign, IL)                   | 1996                       | 2/21/2006        | 20,400                  | 100%      | 2024                | 263  | 12.89  | 1,545        |
| 2109 Fox Drive<br><br>(Champaign, IL)                   | 1996                       | 2/21/2006        | 40,000                  | 100%      | 2024                | 517  | 12.93  | 3,030        |
| 2215 Fox Drive<br><br>(Champaign, IL)                   | 1996                       | 2/21/2006        | 25,000                  | 100%      | 2024                | 323  | 12.92  | 1,894        |
| 2301 Fox Drive<br><br>(Champaign, IL)                   | 1996                       | 2/21/2006        | 22,862                  | 100%      | 2024                | 295  | 12.90  | 1,731        |
| 12000 Portland<br>Avenue South<br><br>(Burnsville, MN)  | 1984                       | 5/10/2006        | 114,959                 | 100%      | 2023                | 1,091  | 9.49   | 11,001       |
| 14701 Anthony<br>Avenue<br><br>(Menomonee<br>Falls, WI) | 1986/2000                  | 6/30/2006        | 125,692                 | 100%      | 2016                | 786  | 6.25   | 6,738        |
| 1025 Birdsong<br>Drive<br><br>(Baytown, TX)             | 1997                       | 7/11/2006        | 12,000                  | 0%        | 2013                |  |  | 2,000        |
| 2150, 2200<br>Pinson Valley<br>Parkway                  | 1961/1980                  | 9/29/2006        | 63,514                  | 100%      | 2016                | 271  | 4.27   |              |

|  |                      |                         |                  |             |              |            |                |       |  |
|--|----------------------|-------------------------|------------------|-------------|--------------|------------|----------------|-------|--|
| (Birmingham, AL)<br>2325 West<br>Fairview Avenue |                      |                         |                  |             |              |            |                |       |  |
| (Montgomery, AL)<br>5221 N Highway<br>763        | 1962/1989            | 9/29/2006               | 29,472           | 100%        | 2016         | 126        | 4.28           |       |  |
| (Columbia, MO)<br>4690 Parkway<br>Drive          | 1978                 | 9/29/2006               | 16,275           | 100%        | 2016         | 69         | 4.24           |       |  |
| (Mason, OH)<br>201 South<br>Rogers Lane          | 2002                 | 1/5/2007                | 60,000           | 100%        | 2020         | 554        | 9.23           | 4,250 |  |
| (Raleigh, NC)<br>1110 West<br>Tenkiller          | 1994                 | 2/16/2007               | 115,500          | 100%        | 2015         | 717        | 6.21           | 5,164 |  |
| (Tulsa, OK)<br>3725 East 10th<br>Court           | (3)<br>2004          | 3/1/2007                | 238,310          | 100%        | 2019         | 1,566      | 6.57           | 7,776 |  |
| (Hialeah, FL)<br>554 Clark Road                  | 1956/1992            | 3/9/2007                | 132,337          | 100%        | 2027         | 1,109      | 8.38           |       |  |
| (Tewksbury, MA)<br>5324 Natorp<br>Boulevard      | 1985/1989            | 5/17/2007               | 102,200          | 100%        | 2017         | 799        | 7.82           |       |  |
| (Mason, OH)<br>7282 Willam<br>Barry Boulevard    | 2007                 | 7/1/2007                | 21,264           | 100%        | 2027         | 583        | 27.42          | 4,555 |  |
| (Cicero, NY)<br>1515 Arboretum<br>Drive SE       | 2005                 | 9/6/2007                | 71,880           | 100%        | 2020         | 530        | 7.37           | 3,964 |  |
| (Grand Rapids, MI)<br>4 Territorial<br>Court     | 2001                 | 9/28/2007               | 63,235           | 100%        | 2025         | 1,090      | 17.24          | 5,831 |  |
| (Bollingbrook, IL)<br>2349<br>Lawrenceville      | (11)<br>2002<br>1989 | 9/28/2007<br>12/13/2007 | 55,480<br>16,740 | 38%<br>100% | 2022<br>2031 | 636<br>516 | 11.38<br>30.82 |       |  |

|               |      |            |       |      |      |     |       |
|---------------|------|------------|-------|------|------|-----|-------|
| Highway       |      |            |       |      |      |     |       |
| (Decatur, GA) |      |            |       |      |      |     |       |
| 2341          |      |            |       |      |      |     |       |
| Lawrenceville |      |            |       |      |      |     |       |
| Highway       |      |            |       |      |      |     |       |
| (Decatur, GA) | 1989 | 12/13/2007 | 4,372 | 100% | 2031 | 135 | 30.88 |
| 2339          |      |            |       |      |      |     |       |
| Lawrenceville |      |            |       |      |      |     |       |
| Highway       |      |            |       |      |      |     |       |
| (Decatur, GA) | 1989 | 12/13/2007 | 5,488 | 100% | 2031 | 169 | 30.79 |

**Table of Contents****Item 2. Properties (Continued)**

| Property   | Year Built/<br>Improvements | Date of Purchase | Rentable<br>Square Feet | Occupancy | Lease<br>Expiration | Total Rental Income<br>Year ended<br>December 31, 2014 <sup>(4)</sup> | Total Rental<br>Income<br>per<br>Occupied Square<br>Foot | Rental<br>Encumbrances |
|--|-----------------------------|------------------|-------------------------|-----------|---------------------|---|--|------------------------|
| 311 Phillip<br>Boulevard<br><br>(Lawrenceville,<br>GA) | 2005                        | 12/13/2007       | 12,412                  | 100%      | 2031                | \$ 447  | \$ 36.01   | \$                     |
| 2096 McGee<br>Road<br><br>(Snellville, GA)             | 1986                        | 12/13/2007       | 3,800                   | 100%      | 2031                | 116   | 30.53  |                        |
| 7174 Wheat<br>Street<br><br>(Covington, GA)            | 2000                        | 12/13/2007       | 5,000                   | 100%      | 2031                | 153   | 30.60  |                        |
| 1055 Haw Creek<br>Parkway<br><br>(Cumming, GA)         | 2004                        | 12/13/2007       | 13,919                  | 100%      | 2026                | 486   | 34.92  | 3,145                  |
| 1293 Wellbrook<br>Circle<br><br>(Conyers, GA)          | 1994                        | 12/13/2007       | 6,400                   | 100%      | 2031                | 195   | 30.47  |                        |
| 425 Gateway<br>Drive<br><br>(Reading, PA)              | 2007                        | 1/29/2008        | 42,900                  | 100%      | 2028                | 717   | 16.71  | 3,983                  |
| 6499 University<br>Avenue NE<br><br>(Fridley, MN)      | 1985/2006                   | 2/26/2008        | 74,160                  | 100%      | 2020                | 812   | 10.95  | 5,121                  |
| 7528 Auburn<br>Road<br><br>(Concord<br>Township, OH)   | 1957/2008                   | 3/31/2008        | 273,300                 | 100%      | 2024                | 1,665   | 6.09   |                        |
| 10021 Rodney<br>Street<br><br>(Pineville, NC)          | 1985                        | 4/30/2008        | 74,950                  | 100%      | 2028                | 431   | 5.75   | 2,315                  |
| 28305 State<br>Route 7                                 | 1992/2007                   | 8/29/2008        | 223,458                 | 100%      | 2028                | 909   | 4.07   | 5,650                  |

|  |      |            |         |      |      |       |       |        |  |
|--|------|------------|---------|------|------|-------|-------|--------|--|
| (Marietta, OH)<br>400 Highpoint<br>Drive                                       |      |            |         |      |      |       |       |        |  |
| (Chalfont, PA)<br>1520 Albany<br>Place SE                                      | 1987 | 8/29/2008  | 67,200  | 100% | 2016 | 758   | 11.28 | 5,510  |  |
| (Orange City, IA)<br>2415 Century<br>Place SE                                  | 1990 | 12/15/2010 | 487,121 | 100% | 2026 | 1,229 | 2.52  | 9,015  |  |
| (Hickory, NC)<br>2645 North<br>Airport Plaza<br>Avenue, Lot 2                  | 2008 | 4/4/2011   | 60,000  | 100% | 2020 | 937   | 15.62 | 6,697  |  |
| (Springfield,<br>MO)<br>124 East Hines<br>Road                                 | 2006 | 6/20/2011  | 78,421  | 100% | 2021 | 1,422 | 18.13 | 10,977 |  |
| (Boston Heights,<br>OH)<br>9 Sylvan Way  | 2011 | 10/20/2011 | 25,000  | 100% | 2021 | 377   | 15.08 | 2,646  |  |
| (Parsippany, NJ)<br>495 State Road   | 1984 | 10/28/2011 | 60,111  | 100% | 2026 | 1,157 | 19.25 | 6,799  |  |
| (Dartmouth, MA) <sup>(3)</sup> <sup>(5)</sup><br>1955 South<br>National Avenue | 2011 | 11/18/2011 | 16,340  | 100% | 2086 | 625   | 38.25 | 4,049  |  |
| (Springfield,<br>MO) <sup>(3)</sup> <sup>(6)</sup><br>810 Parish Street        | 2005 | 12/13/2011 | 14,560  | 100% | 2080 | 315   | 21.63 | 1,823  |  |
| (Pittsburgh, PA)   | 1968 | 12/28/2011 | 26,080  | 100% | 2026 | 400   | 15.34 | 2,757  |  |

**Table of Contents****Item 2. Properties (Continued)**

| Property   | Year Built/<br>Improvements | Date of Purchase | Rentable<br>Square Feet | Occupancy | Year of<br>Lease<br>Expiration | Total Rental Income for<br>the<br>year<br>ended<br>December 31,<br>2014 |          |          | Total Rental<br>Income<br>per<br>Square<br>Foot | Encumbrances |
|--|-----------------------------|------------------|-------------------------|-----------|--------------------------------|---|----------|----------|---|--------------|
|  |                             |                  |                         |           |                                | (4)   |          |          |   |              |
| 44426<br>Atwater<br>Place<br><br>(Ashburn,<br>VA)        | 2002                        | 1/25/2012        | 52,130                  | 100%      | 2027                           | \$ 989  | \$ 18.97 | \$ 7,223 |   |              |
| 14955 6th<br>Street<br><br>(Ottumwa,<br>IA)              | 1970                        | 5/30/2012        | 352,860                 | 100%      | 2023                           | 693   | 1.96     | 4,426    |   |              |
| 7800 Walton<br>Parkway<br><br>(New<br>Albany, OH)        | 2007                        | 6/5/2012         | 89,000                  | 100%      | 2023                           | 1,357   | 15.25    | 9,066    |   |              |
| 7200 North<br>Lake Drive<br><br>(Columbus,<br>GA)        | 2012                        | 6/21/2012        | 32,000                  | 100%      | 2023                           | 656   | 20.50    | 4,507    |   |              |
| 3592<br>Corporate<br>Drive<br><br>(Columbus,<br>OH)      | 1981                        | 6/28/2012        | 31,293                  | 100%      | 2022                           | 331   | 10.58    | 2,845    |   |              |
| 1395<br>University<br>Boulevard<br><br>(Jupiter, FL)     | 2011                        | 9/26/2012        | 60,000                  | 100%      | 2023                           | 1,372   | 22.87    | 10,252   |   |              |
| 1400 John<br>Burgess<br>Drive<br><br>(Fort Worth,<br>TX) | 2005                        | 11/8/2012        | 208,234                 | 100%      | 2026                           | 1,628   | 7.82     | 13,567   |   |              |

|  |      |            |         |      |           |                      |                      |        |
|--|------|------------|---------|------|-----------|----------------------|----------------------|--------|
| 565 Spears<br>Creek<br>Church Road<br><br>(Columbia,<br>SC)<br>6725 Delilah<br>Road<br><br>(Egg Harbor<br>Township,<br>NJ)<br>17499<br>Brookwood<br>Parkway<br><br>(Vance, AL)<br>3785<br>Pheasant<br>Ridge Drive<br>NE<br><br>(Blaine, MN)<br>717 E.<br>Parmer Lane<br><br>(Austin, TX)<br>805 Central<br>Expressway<br>South<br><br>(Allen, TX) <sup>(7)</sup><br>349<br>Inverness<br>Drive South<br><br>(Englewood,<br>CO)<br>43700<br>Gen-Mar<br>Drive<br><br>(Novi, MI)<br>1207 West<br>McDermott<br>Drive<br><br>(Allen, TX)<br>6805<br>Colleyville<br>Boulevard | 2010 | 11/21/2012 | 146,483 | 100% | 2022      | 2,541                | 17.35                | 18,067 |
|  | 1985 | 3/28/2013  | 29,257  | 100% | 2023      | 496                  | 16.95                | 3,551  |
|  | 2013 | 5/9/2013   | 170,000 | 100% | 2023      | 1,173                | 6.90                 |        |
|  | 2009 | 5/10/2013  | 92,275  | 100% | 2020      | 1,475                | 15.98                | 8,045  |
|  | 1999 | 7/9/2013   | 320,000 | 100% | 2020      | 4,805                | 15.02                | 34,567 |
|  | 1998 | 7/10/2013  | 115,200 | 100% | 2021/2022 | 1,879 <sup>(9)</sup> | 16.31                | 8,704  |
|  | 2008 | 12/11/2013 | 99,797  | 100% | 2021      | 1,504                | 15.07                | 11,315 |
|  | 1988 | 12/27/2013 | 156,200 | 100% | 2024      | 684                  | 4.38                 | 4,297  |
|  | 2004 | 3/27/2014  | 21,154  | 100% | 2026      | 435                  | 26.96 <sup>(2)</sup> | 3,417  |
|  | 2000 | 3/27/2014  | 20,355  | 100% | 2026      | 357                  | 22.93 <sup>(2)</sup> | 2,797  |

|   |                     |           |         |      |           |                    |                      |        |  |
|---|---------------------|-----------|---------|------|-----------|--------------------|----------------------|--------|--|
| (Colleyville,<br>TX)<br>3078<br>Prospect<br>Park Drive        |                     |           |         |      |           |                    |                      |        |  |
| (Rancho<br>Cordova,<br>CA)<br>300 South<br>Denton Tap<br>Road | 1986                | 4/22/2014 | 61,358  | 100% | 2024      | 625 <sup>(9)</sup> | 14.72 <sup>(2)</sup> | 4,935  |  |
| (Coppell,<br>TX)<br>7450<br>Huntington<br>Park Drive          | 2005                | 5/8/2014  | 21,171  | 100% | 2026      | 390                | 28.40 <sup>(2)</sup> | 3,767  |  |
| (Columbus,<br>OH)<br>6 Kane Lane                              | <sup>(8)</sup> 1986 | 5/13/2014 | 114,786 | 100% | 2016/2023 | 790 <sup>(9)</sup> | 11.13 <sup>(2)</sup> |        |  |
| (Taylor, PA)  | 2000/2006           | 6/9/2014  | 955,935 | 100% | 2024      | 1,908              | 3.56 <sup>(2)</sup>  | 22,600 |  |

**Table of Contents****Item 2. Properties (Continued)**

| Property  | Year Built/<br>Improvement | Date of Purchase | Rentable<br>Square Feet | Occupancy | Year of<br>Lease<br>Expiration | Total Rental Income<br>the year<br>ended<br>December 31,<br>2014 <sup>(4)</sup> | Total Rental<br>Income<br>per<br>Occupied Square<br>Foot | Encumbrances      |
|---|----------------------------|------------------|-------------------------|-----------|--------------------------------|---|--|-------------------|
| 14800 East<br>Moncrieff<br>Place<br><br>(Aurora, CO)      | 1983                       | 7/1/2014         | 124,800                 | 100%      | 2029                           | 384   | 6.16 <sup>(2)</sup>                                      |                   |
| 6626 E. 75th<br>Street<br><br>(Indianapolis,<br>IN)       | <sup>(10)</sup> 1981/2014  | 9/3/2014         | 86,495                  | 96%       | 2015-2026                      | 489 <sup>(9)</sup>  | 17.38 <sup>(2)</sup>                                     | 6,100             |
| 1485 East<br>61st Avenue<br><br>(Denver, CO)              | 1985                       | 10/31/2014       | 189,120                 | 100%      | 2024                           | 166   | 4.55 <sup>(2)</sup>                                      |                   |
| 1833<br>Frenchtown<br>Center Drive<br><br>(Monroe,<br>MI) | 2004                       | 12/23/2014       | 315,000                 | 100%      | 2023                           | 36  | 4.71 <sup>(2)</sup>                                      | 10,839            |
| 2200 Revard<br>Road<br><br>(Monroe,<br>MI)                | 2004                       | 12/23/2014       | 220,500                 | 100%      | 2023                           | 25  | 4.71 <sup>(2)</sup>                                      | 7,587             |
| <b>Totals</b>   |                            |                  | 10,633,474              |           |                                | <b>\$ 69,928</b> <sup>(12)</sup>  |  | <b>\$ 458,592</b> |

- (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 2014.
- (3) Property subject to a ground lease.
- (4) Total rental income included in this table is straight-line rental income calculated in accordance with Generally Accepted Accounting Principles in the United States.
- (5) Tenant has the option to terminate the lease in years 2036-2086.
- (6) Tenant has the option to terminate the lease in years 2030-2080.
- (7) Two tenants occupy this building each with separate leases ending in different years. The tenant occupying 73% of the building has their lease expire in 2022. The tenant occupying the remaining space has their lease expire in 2021.
- (8) Two tenants occupy this building each with separate leases ending in different years. The tenant occupying 92% of the building has their lease expire in 2023. The tenant occupying the remaining space has their lease expire in 2016.

- (9) At least one tenant occupying this properties is subject to a gross lease.
- (10) Seven tenants occupy this building each with separate leases ending in different years. The tenant occupying 71% of the building lease expires in 2026. The remaining six tenants have lease terms expiring from 2015 through 2018.
- (11) Our previous tenant's lease expired on December 31, 2014. Our current tenant is occupying approximately 38% of the building, and their lease expires in 2022.
- (12) The rental income figure excludes rental revenues earned prior to our Sterling Heights, MI sale, and our Roseville, MN deed-in-lieu transaction. Total rental revenue for the year ended December 31, 2014 for these properties was \$1,283.

The following table summarizes the lease expirations by year for our properties for leases in place as of December 31, 2014 (dollars in thousands):

| Year of Lease Expiration | Square Feet <sup>(1)</sup> | Number of Expiring Leases | Rental Revenue for the year ended December 31, 2014 | % of Annualized Base Rent |
|--------------------------|----------------------------|---------------------------|---|---------------------------|
| 2015                     | 701,148                    | 7                         | \$ 4,090  | 5.9%                      |
| 2016                     | 315,183                    | 5                         | 2,127   | 3.1                       |
| 2017                     | 372,885                    | 6                         | 1,931   | 2.8                       |
| 2018                     | 78,968                     | 4                         | 770   | 1.1                       |
| 2019                     | 302,810                    | 2                         | 2,657   | 3.8                       |
| 2020                     | 1,246,594                  | 11                        | 13,216  | 19.1                      |
| 2021                     | 518,276                    | 6                         | 5,119   | 7.4                       |
| 2022+                    | 7,047,887                  | 50                        | 39,400  | 56.8                      |
| <b>Total</b>             | <b>10,583,751</b>          | <b>91</b>                 | <b>\$ 69,310 <sup>(2)</sup></b>                     | <b>100%</b>               |

- (1) Our fully vacant building in Baytown, TX contains 12,000 square feet. We have 34,535 square feet vacant in our Bolingbrook, IL property, and 3,188 square feet vacant in our Indianapolis, IN property.
- (2) The rental income figure excludes rental revenues earned on our expired lease at Bolingbrook, IL, and rental income earned prior to our Sterling Heights, MI sale, and our Roseville, MN deed-in-lieu transaction. Total rental revenue for the year ended December 31, 2014 for these properties was \$1,901.

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The following table summarizes the geographic locations of our properties as of December 31, 2014 (dollars in thousands):

| State            | Rental Revenue for<br>the year<br>ended |                | Number of Leases<br>for the year<br>ended |
|------------------|---|----------------|---|
|                  | December 31, 2014                       | % of Base Rent |   |
| Texas            | \$ 11,674                               | 16.4%          | 10  |
| Ohio             | 9,896                                   | 13.9           | 17  |
| North Carolina   | 5,165                                   | 7.3            | 7   |
| Pennsylvania     | 5,133                                   | 7.2            | 6   |
| South Carolina   | 4,463                                   | 6.3            | 2   |
| Minnesota        | 4,153                                   | 5.8            | 3   |
| New Jersey       | 3,178                                   | 4.5            | 4   |
| Georgia          | 2,874                                   | 4.0            | 3   |
| Massachusetts    | 2,584                                   | 3.6            | 4   |
| All Other States | 22,091                                  | 31.0           | 35  |
| <b>Total</b>     | <b>\$ 71,211</b>                        | <b>100%</b>    | <b>91</b>                                 |

The following table summarizes rental income by tenant industries for the years ended December 31, 2014, 2013 and 2012 (dollars in thousands):

| Industry Classification                     | For the year ended December 31, |                                |               |                                |               |                                |
|---|---------------------------------|--------------------------------|---------------|--------------------------------|---------------|--------------------------------|
|   | 2014                            |                                | 2013          |                                | 2012          |                                |
|   | Rental Income                   | Percentage of<br>Rental Income | Rental Income | Percentage of<br>Rental Income | Rental Income | Percentage of<br>Rental Income |
| Telecommunications                          | \$ 12,570                       | 17.7%                          | \$ 10,102     | 17.0%                          | \$ 7,351      | 14.4%                          |
| Healthcare                                  | 8,692                           | 12.2                           | 7,486         | 12.5                           | 5,228         | 10.3                           |
| Automobile                                  | 8,587                           | 12.1                           | 5,589         | 9.4                            | 1,944         | 3.8                            |
| Electronics                                 | 5,731                           | 8.0                            | 4,982         | 8.3                            | 6,189         | 12.3                           |
| Personal, Food & Miscellaneous<br>Services  | 5,493                           | 7.7                            | 5,231         | 8.8                            | 2,479         | 4.9                            |
| Diversified/Conglomerate                    |                                 |                                |               |                                |               |                                |
| Manufacturing                               | 4,049                           | 5.7                            | 3,665         | 6.1                            | 3,664         | 7.2                            |
| Chemicals, Plastics & Rubber                | 3,256                           | 4.6                            | 3,236         | 5.4                            | 3,153         | 6.2                            |
| Diversified/Conglomerate Services           | 3,153                           | 4.4                            | 1,244         | 2.1                            | 1,244         | 2.4                            |
| Beverage, Food & Tobacco                    | 2,994                           | 4.2                            | 3,007         | 5.0                            | 2,844         | 5.6                            |
| Machinery                                   | 2,643                           | 3.7                            | 2,265         | 3.8                            | 2,259         | 4.4                            |
| Personal & Non-Durable Consumer<br>Products | 2,607                           | 3.7                            | 2,583         | 4.3                            | 2,507         | 4.9                            |
| Buildings and Real Estate                   | 2,181                           | 3.1                            | 2,160         | 3.6                            | 2,144         | 4.2                            |
| Containers, Packaging & Glass               | 2,086                           | 2.9                            | 2,171         | 3.6                            | 2,344         | 4.6                            |
| Printing & Publishing                       | 1,783                           | 2.5                            | 1,848         | 3.1                            | 1,894         | 3.7                            |

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|                           |           |        |           |        |           |        |
|---------------------------|-----------|--------|-----------|--------|-----------|--------|
| Childcare                 | 1,765     | 2.5    | 583       | 1.0    | 583       | 1.1    |
| Oil & Gas                 | 1,278     | 1.8    | 1,275     | 2.1    | 1,271     | 2.5    |
| Banking                   | 1,157     | 1.6    | 1,156     | 1.9    | 1,149     | 2.3    |
| Education                 | 656       | 0.9    | 656       | 1.1    | 2,138     | 4.2    |
| Home & Office Furnishings | 530       | 0.7    | 530       | 0.9    | 530       | 1.0    |
|                           | \$ 71,211 | 100.0% | \$ 59,769 | 100.0% | \$ 50,915 | 100.0% |

**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. Mine Safety Disclosures.**

Not applicable.

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, or NASDAQ, under the symbol GOOD. The following table reflects the range of the high and low sale prices of our common stock on NASDAQ and the distributions per common share for the years ended December 31, 2014 and 2013. Distributions to common stockholders are declared quarterly and paid monthly. Amounts presented represent the cumulative amount of the monthly common stock distributions declared and paid during such quarter.

|            | Price Range |          | Distributions Per<br>Common Share |
|------------|-------------|----------|-----------------------------------|
|            | High        | Low      |                                   |
| 2013       |             |          |                                   |
| 3/31/2013  | \$ 19.51    | \$ 17.98 | \$ 0.375                          |
| 6/30/2013  | 21.33       | 17.89    | 0.375                             |
| 9/30/2013  | 19.16       | 17.25    | 0.375                             |
| 12/31/2013 | 19.09       | 17.25    | 0.375                             |
| 2014       |             |          |                                   |
| 3/31/2014  | \$ 18.67    | \$ 17.08 | \$ 0.375                          |
| 6/30/2014  | 17.99       | 16.84    | 0.375                             |
| 9/30/2014  | 18.41       | 16.94    | 0.375                             |
| 12/31/2014 | 18.25       | 16.41    | 0.375                             |

Since inception in 2003, we have never reduced our per-share distributions nor have we missed payment of a scheduled distribution to our common 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 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, taxable income, 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 common shares then outstanding, and any common distribution payable may vary from such expected amounts.

To qualify as a REIT, we are required to make ordinary dividend distributions to our common 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.

For federal income tax purposes, our common 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.

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A covenant in the agreement governing our Line of Credit requires us to, among other things, limit our distributions to stockholders to 100% of our FFO, and continued compliance with this covenant may require us to limit our distributions to stockholders in the future. For a discussion of our Line of Credit, including the financial and operating covenants required for us to access this source of financing, see *Risk Factors 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* and *Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Line of Credit* herein.

As of February 4, 2015, there were 15,093 beneficial owners of our common stock.

The Company pays distributions on shares of Senior Common Stock in an amount equal to \$1.05 per share per annum, declared daily and paid at the rate of \$0.0875 per share per month. The Senior Common Stock is not traded on any exchange or automated quotation system.

As of February 4, 2015, there were 284 beneficial owners of our Senior Common Stock.

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

The following selected financial data as of and for each of the fiscal years ended December 31, 2014, 2013, 2012, 2011 and 2010 is derived from our audited consolidated financial statements. 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.

|   | For the year ended December 31,<br>(Dollars in Thousands, Except Per Share Amounts) |            |            |            |           |
|---|---|------------|------------|------------|-----------|
|   | 2014  | 2013       | 2012       | 2011       | 2010      |
| <b>Operating Data:</b>  |   |            |            |            |           |
| Total operating revenue   | \$ 73,756   | \$ 61,343  | \$ 51,270  | \$ 43,976  | \$ 41,928 |
| Total operating expenses  | (57,406)  | (32,823)   | (24,895)   | (21,270)   | (23,414)  |
| Other expense   | (22,252)  | (26,993)   | (22,614)   | (16,992)   | (13,586)  |
| Net (loss) income   | \$ (5,902)  | \$ 1,527   | \$ 3,761   | \$ 5,714   | \$ 4,928  |
| Dividends attributable to preferred stock                             | (4,094)   | (4,094)    | (4,093)    | (4,094)    | (4,094)   |
| Dividends attributable to senior common stock                         | (542)   | (300)      | (113)      | (62)       | (20)      |
| Net (loss) income available to common stockholders                    | \$ (10,538)   | \$ (2,867) | \$ (445)   | \$ 1,558   | \$ 814    |
| <b>Share and Per Share Data:</b>                                      |   |            |            |            |           |
| (Loss) earnings per weighted average common share - basic & diluted   | \$ (0.61)   | \$ (0.22)  | \$ (0.04)  | \$ 0.15    | \$ 0.09   |
| Weighted average common shares outstanding-basic                      | 17,253,503  | 13,164,244 | 10,953,325 | 10,236,859 | 8,576,303 |
| Weighted average common shares outstanding-diluted                    | 17,253,503  | 13,164,244 | 10,953,325 | 10,288,711 | 8,601,153 |
| Cash dividends declared per common share                              | \$ 1.50   | \$ 1.50    | \$ 1.50    | \$ 1.50    | \$ 1.50   |
| <b>Supplemental Data:</b>   |   |            |            |            |           |
| Net (loss) income available to common stockholders                    | \$ (10,538)   | \$ (2,867) | \$ (445)   | \$ 1,558   | \$ 814    |
| Add: Real estate depreciation and amortization                        | 28,864  | 22,827     | 16,831     | 14,149     | 13,264    |
| Add: Impairment charge  | 14,238  |            |            |            |           |
| Less: Gain on sale of real estate                                     | (1,240)   |            |            |            |           |
| Funds from operations available to common stockholders <sup>(1)</sup> | \$ 31,324   | \$ 19,960  | \$ 16,386  | \$ 15,707  | \$ 14,078 |

**Balance Sheet Data:**

|   |            |            |            |            |            |
|---|------------|------------|------------|------------|------------|
| Real estate, before accumulated depreciation  | \$ 722,565 | \$ 642,353 | \$ 533,753 | \$ 442,521 | \$ 401,017 |
| Total assets  | 787,794    | 690,525    | 564,779    | 453,147    | 410,609    |
| Mortgage notes payable, term loan, term preferred stock and borrowings under the line of credit | 541,099    | 485,502    | 422,685    | 304,050    | 286,595    |
| Total stockholders equity   | 217,672    | 183,146    | 122,365    | 135,314    | 111,375    |
| Total common shares outstanding   | 19,589,606 | 15,662,414 | 11,083,584 | 10,945,379 | 8,724,613  |

- (1) The National Association of Real Estate Investment Trusts, or NAREIT, developed FFO as a relevant non-GAAP supplemental measure of operating performance of an equity REIT, to recognize that income-producing real estate historically has not depreciated on the same basis determined under GAAP. FFO, as defined by NAREIT, is net income (computed in accordance with GAAP), excluding gains or losses from sales of property and impairment losses on 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, which, unlike FFO, generally reflects all cash effects of transactions and other events in the determination of net income and should not be considered an alternative to net income as an indication of our performance or to cash flows from operations as a measure of liquidity or ability to make distributions. Comparison of FFO, using the NAREIT definition, 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 Stock share distributions. We believe that net (loss) 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 the number of weighted average shares of common stock outstanding and FFO available to common stockholders divided by the number of weighted average shares of common stock 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 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, because most REITs provide FFO available to common stockholders, Basic FFO and Diluted FFO per share information to the

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investment community, we believe these are useful supplemental measures when 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, 2014, 2013, 2012, 2011 and 2010 to the most directly comparable GAAP measure, net (loss) income, and a computation of basic and diluted FFO per weighted average common share:

|   | For the year ended December 31,<br>(Dollars in Thousands, Except for Per Share Amounts) |            |            |            |           |
|---|---|------------|------------|------------|-----------|
|   | 2014  | 2013       | 2012       | 2011       | 2010      |
| Net (loss) income   | \$ (5,902)  | \$ 1,527   | \$ 3,761   | \$ 5,714   | \$ 4,928  |
| Less: Distributions attributable to preferred and senior common stock | (4,636)   | (4,394)    | (4,206)    | (4,156)    | (4,114)   |
| Net (loss) income attributable to common stockholders                 | \$ (10,538)   | \$ (2,867) | \$ (445)   | \$ 1,558   | \$ 814    |
| Adjustments:  |   |            |            |            |           |
| Add: Real estate depreciation and amortization                        | 28,864  | 22,827     | 16,831     | 14,149     | 13,264    |
| Add: Impairment charge  | 14,238  |            |            |            |           |
| Less: Gain on sale of real estate                                     | (1,240)   |            |            |            |           |
| FFO available to common stockholders                                  | \$ 31,324   | \$ 19,960  | \$ 16,386  | \$ 15,707  | \$ 14,078 |
| Weighted average common shares outstanding - basic                    | 17,253,503  | 13,164,244 | 10,953,325 | 10,236,859 | 8,576,303 |
| Weighted average common shares outstanding - diluted                  | 17,682,012  | 13,402,370 | 11,075,216 | 10,288,711 | 8,601,153 |
| Basic FFO per weighted average share of common stock                  | \$ 1.82   | \$ 1.52    | \$ 1.50    | \$ 1.53    | \$ 1.64   |
| Diluted FFO per weighted average share of common stock                | \$ 1.77   | \$ 1.49    | \$ 1.48    | \$ 1.53    | \$ 1.64   |
| Distributions declared per share of common stock                      | \$ 1.50   | \$ 1.50    | \$ 1.50    | \$ 1.50    | \$ 1.50   |

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### **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.*

#### **General**

We are an externally-advised real estate investment trust, or REIT, that was 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, commercial and retail real property and selectively making long-term industrial and commercial mortgage loans. Our portfolio of real estate 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 actively communicate 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. We currently own 96 properties totaling 10.6 million square feet, which have a total gross and net carrying value, including intangible assets, of \$861.3 million and \$729.2 million, respectively. We also currently have one mortgage loan receivable outstanding for \$5.6 million.

#### **Business Environment**

The strength of the global economy and the U.S. economy in particular, continues to be uncertain and volatile, and we remain cautious about a long-term economic recovery. Vacancy rates have decreased for both office and industrial properties in many markets as increased user demand with restrained new construction activity has led to improved conditions. However, vacancy rates in certain markets are still higher than pre-recessionary levels, as job growth has yet to return to all areas of the country even though the national unemployment rate has dropped over the past 12 months. Interest rates have decreased since the beginning of the year, and remain at historic lows. This continued low interest rate environment is leading to increasing competition for new acquisitions. In addition, the uncertainty surrounding the ability of the federal government to address its fiscal condition in both the near and long term has increased domestic and global economic instability. These developments and the government's credit concerns in general, could cause interest rates and borrowing costs to rise, which may negatively impact our ability to access both the debt and equity markets on favorable terms. In addition, a further decrease to the U.S. credit rating could create broader financial turmoil and uncertainty, which may weigh heavily on our stock price. Continued adverse economic conditions could have a material adverse effect on one or more of our tenants, or our business, financial condition and results of operations.

We continue to focus on re-leasing vacant space, renewing upcoming lease maturities and acquiring additional properties. We now only have one fully vacant building located in Baytown, Texas and one partially vacant building located in Bolingbrook, Illinois. Our Baytown, Texas tenant vacated upon their lease termination in April 2013, and our Bolingbrook, Illinois tenant vacated upon their lease termination in December 2014. We have identified a partial space user for our Bolingbrook, Illinois property, which took occupancy in December 2014. We originally had 12 leases expiring in 2015, and we have successfully extended the leases for 7 of these tenants, one in negotiation with the tenant, and one in which we are negotiating to sell the property to a subtenant. We have been notified that 3 tenants will leave. We are aggressively pursuing new tenants for these properties. The 3 leases, where we know the tenants are vacating, comprise less than 3% of our projected 2015 rental income, and 50% of this income does not expire until December 2015. While we originally had 12 leases rolling in 2015, we only have 4 leases expiring in 2016, 4 in 2017 and 1 in 2018, which are each less than 2% of annualized rents for each respective year.

Our available vacant space at December 31, 2014 comprises less than 1.0% of our total square footage and the annual carrying costs are approximately \$0.3 million. We continue to actively seek new tenants for these properties.

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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 mortgage loans secured by properties and borrowings under our line of credit, or the Line of Credit. The market for long-term mortgages continues to improve and long-term mortgages are readily obtainable. The collateralized mortgage backed securities, or CMBS, market remains active but it is more conservative and restrictive than it was prior to the recession and uncertainty with regard to interest rates has made the CMBS market less predictable. We continue to look to regional banks, insurance companies and other non-bank lenders, in addition to the CMBS market to issue mortgages to finance our real estate activities.

In addition to obtaining funds through borrowing, we have been active in the equity markets during 2014. We have issued shares of common stock in both an overnight offering in June and through our at-the-market programs, or ATM Programs, pursuant to our former open market sale agreement with Jefferies, LLC, or Jefferies, and our current agreement with Cantor Fitzgerald & Co., or Cantor Fitzgerald, each discussed in more detail below. In addition, we have issued shares of our convertible senior common stock, or the Senior Common Stock, also discussed in more detail below.

**Recent Developments***2014 Investment Activity*

*Allen and Colleyville, Texas:* On March 27, 2014, we acquired two office buildings, totaling 41,509 square feet, located in Allen and Colleyville, Texas for a total of \$10.0 million, excluding related acquisition expenses of \$0.07 million. We funded these acquisitions with existing cash on hand as well as assuming \$6.3 million of existing mortgage debt on the properties. The same tenant has leased both properties for 12 years and has 4 options to renew the lease for additional periods of 5 years each. The leases provide for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$1.0 million.

*Rancho Cordova, California:* On April 22, 2014, we acquired a 61,358 square foot office building located in Rancho Cordova, California for \$8.2 million, excluding related acquisition expenses of \$0.07 million. We funded this acquisition with existing cash on hand and the issuance of \$4.9 million of mortgage debt on the property. The tenant has leased the property for 10 years and has 1 option to renew the lease for an additional 5 years. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line gross rents of \$0.9 million.

*Coppell, Texas:* On May 8, 2014, we acquired an office building, totaling 21,171 square feet, located in Coppell, Texas for a total of \$5.8 million, excluding related acquisition expenses of \$0.03 million. We funded these acquisitions with existing cash on hand as well as assuming \$3.8 million of existing mortgage debt on this property. The tenant has leased this property for 12 years and has 4 options to renew the lease for additional periods of 5 years each. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$0.6 million.

*Columbus, Ohio:* On May 13, 2014, we acquired a 114,786 square foot office building located in Columbus, Ohio for \$11.8 million, excluding related acquisition expenses of \$0.07 million. We funded this acquisition with existing cash on hand. There are 2 tenants in this property, the largest of which occupies 92% of the space and has 9.5 years remaining on the lease. The other tenant has 2.5 years remaining on the lease. The two leases provide for prescribed rent escalations over the life of the respective leases, with annualized straight line rents of \$1.3 million.

*Taylor, Pennsylvania:* On June 9, 2014, we acquired a 955,935 square foot bulk distribution warehouse located in a submarket of Scranton, Pennsylvania for \$39.0 million, excluding related acquisition expenses of \$0.7 million. We

funded this acquisition with existing cash on hand as well as the issuance of \$22.6 million of mortgage debt on the property. The tenant has leased the property for 10 years and has 3 options to renew the lease for an additional 5 years each and a fourth successive term of 4 years and 11 months. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$3.4 million.

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*Aurora, Colorado:* On July 1, 2014, we acquired a 124,800 square foot building located in Aurora, Colorado, an eastern submarket of Denver near the Denver International Airport, for \$8.3 million, excluding related acquisition expenses of \$0.09 million. We funded this acquisition with existing cash on hand. The tenant has leased the property for 15 years and has 2 options to renew the lease for an additional 5 years each. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$0.8 million.

*Phoenix, Arizona:* On July 25, 2014, we closed a \$5.6 million second mortgage development loan for the construction of an 81,371 square foot, build-to-suit transitional care facility located on a major hospital campus in Phoenix, Arizona. Construction is scheduled to be completed by July 2015 and we will earn 9.0% interest, paid currently in cash, on the loan during construction and through maturity. Prior to completion of the facility, we will be granted a right of first offer to purchase the property at fair value. If we do not purchase the property we will receive an exit fee when the property is sold and the loan is repaid in an amount sufficient for us to earn an internal rate of return of 22% on the second mortgage development loan. The loan is scheduled to mature in July 2016, but has a one-year extension option.

*Indianapolis, Indiana:* On September 3, 2014, we acquired an 86,495 square foot office building located in Indianapolis, Indiana for \$10.5 million, excluding related acquisition expenses of \$0.06 million. We funded this acquisition with existing cash on hand as well as the issuance of \$6.1 million of mortgage debt on the property. There are 7 tenants in this property, the largest of which occupies 71% of the space and has 11.5 years remaining on the lease. This tenant has 2 options to renew the lease for an additional 5 years each. The remaining tenants are occupying between 1,427 and 7,639 square feet in their respective suites, with lease terms expiring from December 2015 through October 2018. Six out of seven leases provide for prescribed rent escalations over the life of the respective leases, with annualized straight line gross rents for all leases of \$1.5 million.

*Denver, Colorado:* On October 31, 2014, we acquired a 189,120 square foot building located in Denver, Colorado, for \$10.0 million, excluding related acquisition expenses of \$0.1 million. We funded this acquisition with existing cash on hand. The tenant has leased the property for 10 years and has 2 options to renew the lease for an additional 10 years each. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$0.9 million.

*Monroe, Michigan:* On December 23, 2014, we acquired two industrial buildings, totaling 535,500 square feet, located in Monroe, Michigan for a total of \$30.8 million, excluding related acquisition expenses of \$0.07 million. We funded these acquisitions with existing cash on hand as well as the issuance of \$18.5 million of mortgage debt on the properties. The same tenant has leased both properties for 8.5 years and has 2 options to renew the leases for additional periods of 5 years each. The leases provide for prescribed rent escalations over the life of the leases, with annualized straight line rents of \$2.5 million.

#### *2014 Sale Activity*

*Sterling Heights, Michigan:* On June 6, 2014, we completed the sale of our Sterling Heights, Michigan property for \$11.4 million and recognized a gain on sale of \$1.2 million. We considered this industrial asset to be non-core to our long term strategy, and we re-deployed the proceeds from this sale into new acquisitions described above.

#### *2014 Disposal Activity*

*Roseville, Minnesota:* On November 12, 2014, we completed a deed-in-lieu transaction on our Roseville, Minnesota property, where we returned the property to the lender in exchange for cancellation of obligations under our debt agreement with the lender. We recorded an impairment charge on this property for \$14.2 million reducing the fair

value to \$10.0 million. When the lender accepted the deed-in-lieu of the outstanding mortgage, and released us from our obligation, we recorded a gain on debt extinguishment of \$5.3 million.

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**Table of Contents***2014 Financing Activity*

The following is a summary of our recent financings:

*Wells Fargo:* On March 27, 2014, through two wholly-owned subsidiaries, we assumed \$6.3 million pursuant to a long-term note payable from Wells Fargo, which is collateralized by a security interest in two of our properties. The note accrues interest at a fixed rate of 5.583% per year and the note has a maturity date of February 2016. We assumed the note in connection with the acquisition of the two properties located in Allen and Colleyville, Texas.

*KeyBank Line of Credit:* On March 28, 2014, we amended our Line of Credit to extend the maturity date one additional year to August 2017. We also modified certain terms under the Line of Credit, including the calculation of the total asset value and unencumbered asset value. The applicable London Interbank Offered Rate, or LIBOR, margins were also reduced by 25 basis points at each pricing level. As a result of these modifications, the availability under our Line of Credit increased by \$1.3 million. In addition, on November 20, 2014, we expanded our Line of Credit from \$60.0 million to \$75.0 million and also increased the maximum commitment by \$25.0 million to \$100.0 million.

*KeyBank:* On April 22, 2014, through a wholly-owned subsidiary, we borrowed \$4.9 million pursuant to a long-term note payable from KeyBank National Association, which is collateralized by a security interest in one of our properties. The note accrues interest at a fixed rate of 4.9% per year and we may not repay this note prior to the last three months of the term, or we would be subject to a prepayment penalty. The note has a maturity date of May 1, 2024. We used the proceeds from the note to acquire the property in Rancho Cordova, California on the same date.

*Wells Fargo:* On May 8, 2014, through a wholly-owned subsidiary, we assumed \$3.8 million pursuant to a long-term note payable from Wells Fargo, which is collateralized by a security interest in one of our properties. The note accrues interest at a fixed rate of 6.3% per year and has a maturity date of June 2016. We assumed the note in connection with the acquisition of the property located in Coppell, Texas on the same date.

*Prudential:* On June 9, 2014, through a wholly-owned subsidiary, we borrowed \$22.6 million pursuant to a long-term note payable from Prudential Mortgage Capital Company, which is collateralized by a security interest in one of our properties. The note accrues interest at a fixed rate of 4.23% per year and has a maturity date of July 1, 2019. We used the proceeds from the note to acquire the property in Taylor, Pennsylvania on the same date.

*Everbank:* On September 3, 2014, through a wholly-owned subsidiary, we borrowed \$6.1 million pursuant to a long-term note payable from Everbank, which is collateralized by a security interest in one of our properties. The note accrues interest at a fixed rate of 4.4% per year and has a maturity date of October 1, 2024. We used the proceeds from the note to acquire the property in Indianapolis, Indiana on the same date.

*Prudential:* On December 23, 2014, through a wholly-owned subsidiary, we borrowed \$18.5 million pursuant to a long-term note payable from Prudential Mortgage Capital Company, which is collateralized by a security interest in two of our properties. The note accrues interest at a fixed rate of 4.04% per year and has a maturity date of January 1, 2025. We used the proceeds from the note to acquire two properties in Monroe, Michigan on the same date.

*2014 Leasing Activities*

*Newburyport, Massachusetts:* On April 4, 2014, our tenant occupying our Newburyport, Massachusetts property notified us of their intention not to exercise their renewal option as the tenant is relocating to Rhode Island. The tenant will continue paying rent and operating expenses through the lease termination date of April 30, 2015. A marketing

representative has been hired and re-leasing activity is currently underway.

*Austin, Texas:* On May 6, 2014, we extended the lease with the tenant occupying our property located in Austin, Texas. The lease covering this property was extended for an additional eight years, through June 2022. The lease was originally set to expire in June 2015. The lease provides for

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prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$0.7 million. In connection with the extension of the lease and modification of certain terms of the lease, we paid \$0.2 million in leasing commissions, and will pay \$1.3 million in tenant improvements prior to second quarter 2015.

*Burnsville, Minnesota:* On June 11, 2014, we extended the lease with the tenant occupying our property located in Burnsville, Minnesota. The new lease covers approximately two-thirds of the space and was extended for an additional eight years, through January 2023. The lease was originally set to expire in June 2015. The tenant in this property will continue to pay rent on the entire building through June 2015, and we are working to identify tenants to lease the remaining one-third of the building. The new lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$1.0 million. Rental income per square foot increased 14% from the previous lease. The lease grants the tenant two options to extend the lease for an additional three years each. In connection with the extension of the lease and the modification of certain terms under the lease, we paid \$0.5 million in leasing commissions, and will pay \$3.3 million in tenant improvements prior to the end of first quarter 2015.

*Akron, Ohio:* On July 7, 2014, we extended the lease with one of the tenants occupying our property located in Akron, Ohio. The new lease covers approximately two-thirds of the space and was extended for an additional five years, through March 2020. The lease was originally set to expire in March 2015. This tenant will continue to pay its existing rent through March 2015. The new lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$0.6 million. The lease grants the tenant two options to extend the lease for an additional five years each. In connection with the extension of the lease and the modification of certain terms under the lease, we paid \$0.2 million in leasing commissions, and will pay \$0.9 million in tenant improvements prior to the end of second quarter 2015. On December 24, 2014, we extended the lease with the other tenant occupying our property located in Akron, Ohio. The new lease covers the remaining space and was extended for an additional five years through March 2020. The lease was originally set to expire in March 2015. This tenant will also continue to pay its existing rent through March 2015. The new lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$0.1 million. The lease grants the tenant two options to extend the lease for an additional five years each. In connection with the extension of the lease and the modification of certain terms under the lease, we will pay \$0.1 million in tenant improvements during fiscal year 2015.

*Concord Township, Ohio:* On September 25, 2014, we modified the lease with the tenant occupying our property located in Concord Township, Ohio. The lease covering this property was adjusted to defer a portion of rental payments covering the period August 2014 through December 2014. The tenant will repay the deferred rent balance monthly during calendar year 2015. On November 14, 2014, we further modified the lease with this tenant. The lease covering this property was adjusted to change the lease termination date from August 2034, to December 2024. Accordingly, annual straight line rent decreased from \$1.7 million under the prior amendment, to \$1.4 million. The lease grants the tenant three options to extend the lease for an additional five years each. Upon execution of this lease amendment, we determined that a portion of our existing deferred rent balance of \$2.5 million was uncollectible, due to the reduction in lease payments and lease term, and we adjusted the balance by approximately \$0.8 million.

*Richmond, Virginia:* On October 16, 2014, we executed a lease with a tenant to occupy our previously vacant property located in Richmond, Virginia. The lease became effective as of September 8, 2014 and has a three-year term. The tenant has an early termination option at any time after July 31, 2016, contingent upon the tenant losing a contract with the customer supporting their operations in our building. The tenant is subject to a termination payment of approximately \$0.03 million if they exercise this option. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$0.2 million. The tenant has one option to renew the lease for an additional period of three years. In connection with the extension of the lease and modification of certain terms of the lease, we paid \$0.1 million in leasing commissions. No tenant improvements were paid by us in connection with the new lease.



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*Canton, North Carolina:* On October 22, 2014, we extended the lease with the tenant occupying our property located in Canton, North Carolina for 10 years through September 2034. The lease was originally set to expire in July 2024. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$1.4 million, as compared to straight line rents of \$0.6 million under the previous lease. We financed a \$5.5 million expansion project on this property, which added an additional 150,000 square feet to the building, which was completed in November 2014.

*South Hadley, Massachusetts:* On October 27, 2014, we extended the lease with the tenant occupying our property located in South Hadley, Massachusetts. The lease covering this property was extended for an additional two years through January 2017. The lease was originally set to expire in January 2015. The lease provides a scheduled rent increase over the previous lease, with annualized straight line rents of approximately \$0.3 million. The tenant has two options to renew the lease for additional periods of one year each. In connection with the extension of the lease and modification of certain terms of the lease, we paid \$0.01 million in leasing commissions.

*Tewksbury, Massachusetts:* On October 30, 2014, we modified the lease with the tenant occupying our property located in Tewksbury, Massachusetts. The lease covering this property was amended to reduce rental charges through the remaining lease term, which is set to expire May 31, 2017. In the event we identify a tenant or a purchaser for the property, we can terminate the lease with the current tenant. Straight line rent on this lease decreased from \$0.9 million per year to \$0.4 million per year after the amendment.

*Maple Heights, Ohio:* On December 1, 2014, we executed a lease with a tenant to occupy a 7,125 square foot vacant outbuilding located on our property in Maple Heights, Ohio. The lease was effective as of December 1, 2014 and has a three-year term. The lease provides for consistent rental payments of \$0.03 million annually. In connection with the extension of the lease and modification of certain terms of the lease, we paid \$0.01 million in leasing commissions.

*Bolingbrook, Illinois:* On December 1, 2014, we executed a lease with a tenant to occupy a portion of our property located in Bolingbrook, Illinois. The lease is for seven years and the tenant occupies 38% of the building. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$0.2 million. The tenant has one option to renew the lease for an additional period of five years. In connection with the extension of the lease and modification of certain terms of the lease, we paid \$0.2 million in leasing commissions, and committed to \$0.5 million in tenant improvements.

*Raleigh, North Carolina:* On February 9, 2015, we modified the leases with the tenant occupying two of our properties, both located in Raleigh, North Carolina. The leases covering these properties were extended for an additional five years each, through July 2020. Both leases were originally set to expire in July 2015. The tenant was previously fully occupying both buildings, totaling 174,426 square feet, but had reduced their space requirement in one of their buildings by 94,200 square feet. Both leases contain prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$0.9 million, as compared to annualized straight line rents of \$1.3 million under the previous terms of the lease. The tenant has two options to renew both leases for an additional period of five years. In connection with the extension of the lease and modification of certain terms of the lease, we anticipate paying \$0.2 million in leasing commissions, and committed to \$0.1 million in tenant improvements.

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### *2014 Equity Activities*

The equity issuances summarized below were issued under our universal shelf registration statement (File No. 333-190931) that was effective and on file with the Securities and Exchange Commission at the time of each respective issuance.

*Common Equity:* We completed a public offering totaling 1,610,000 shares of common stock, which closed on June 6, 2014, at a public offering price of \$17.00 per share. Gross proceeds of this offering totaled \$27.4 million and net proceeds, after deducting offering expenses and underwriter discounts, were \$26.0 million. The proceeds from this offering were used to acquire real estate.

*ATM Programs:* During 2014, we sold 2.3 million shares, raising an aggregate of \$39.6 million in net proceeds under our ATM Programs with both Jefferies LLC, or Jefferies, and Cantor Fitzgerald. Proceeds from these offerings were used to acquire real estate, repay indebtedness and for other general corporate purposes. On August 26, 2014, we provided notice of termination of our prior open market sale agreement, or the Prior ATM, with Jefferies under which we offered 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. We raised \$7.6 million in net proceeds under the Prior ATM during 2014. On September 2, 2014, we entered into a new At the Market sales agreement, or the New ATM, with Cantor Fitzgerald. Under the New ATM we may, from time to time, offer to sell shares of our common stock with an aggregate sales price of up to \$100.0 million on the open market through Cantor Fitzgerald, as agent, or to Cantor Fitzgerald, as principal, based upon our instructions (including any price, time or size limits or other customary parameters or conditions that we may impose). We raised \$32.0 million in net proceeds under the New ATM during 2014. Sales of shares of our common stock through our New ATM are executed by means of ordinary brokers transactions on the NASDAQ Global Select Market, or the NASDAQ, or otherwise at market prices, in privately negotiated transactions, crosses or block transactions, as may be agreed between us and Cantor Fitzgerald, including a combination of any of these transactions.

*Senior Common Equity:* During 2014, we sold 430,963 shares of our Senior Common Stock at \$15.00 per share in an ongoing best-efforts public offering and issued 14,093 shares of our Senior Common Stock under the Dividend Reinvestment Plan, or DRIP, program. The net proceeds, after deducting the underwriting discount and commission were \$5.6 million, net of \$0.2 million of investor redemptions. This offering will terminate on March 28, 2015. Proceeds from this offering were used to acquire real estate and for general corporate purposes.

### **Our Adviser and Administrator**

Our Adviser is led by a management team with 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 and chief operating officer, is also the vice chairman and chief operating officer of our Adviser. Robert Cutlip, our president, is also an executive managing director of our Adviser. Gladstone Administration, LLC, or our Administrator, employs our chief financial officer, treasurer, chief compliance officer, general counsel and secretary (who also serves as our Administrator's president) and their respective staffs. Mr. Gladstone is also the chairman and chief executive officer of our Administrator and Terry Lee Brubaker is the vice chairman and chief operating officer of our Administrator.

Our Adviser and Administrator also provide investment advisory and administrative services, respectively, to certain of our affiliates, including, but not limited to, Gladstone Capital Corporation and Gladstone Investment Corporation, both publicly-traded business development companies, as well as Gladstone Land Corporation, a publicly-traded REIT that primarily invests in farmland. With the exception of Ms. Danielle Jones, our chief financial officer, and

Mr. Robert Cutlip, our president, all of our executive officers and all of our directors serve as either directors or executive officers, or both, of Gladstone Capital Corporation and Gladstone Investment Corporation. In addition, with the exception of our president and our chief financial officer, all of our executive officers and all of our directors, with the exception of Mr. David Dullum, serve as either directors or executive officers, or both, of Gladstone Land Corporation. In the future, our Adviser may provide investment advisory services to other companies, both public and private.

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### **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 investment 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 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).

#### *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 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; however, our Adviser may earn fee income from our borrowers or tenants or other sources. For the year ended December 31, 2014, tenants paid \$310,000 in fees to our Adviser, \$150,000 of which was voluntarily credited to our base management fee, discussed further below. For the years ended December 31, 2013 and 2012, tenants paid \$10,000 in fees to our Adviser, respectively.

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 quarterly 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)



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### Percentage of pre-incentive fee FFO allocated to the 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 100% of FFO with acquisition-related costs that are required to be expensed under ASC 805, Business Combinations, added back to 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, 2014, 2013 and 2012, 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.

### *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 personnel, including our chief financial officer, treasurer, chief compliance officer, general counsel and secretary (who also serves as our Administrator's president), and their respective staffs. Prior to July 1, 2014, our allocable portion was generally derived by multiplying that portion of the Administrator's expenses allocable to all funds managed by the Adviser by the percentage of our total assets at the beginning of each quarter in comparison to the total assets of all funds managed by the Adviser. As approved by our Board of Directors, effective July 1, 2014, our allocable portion of the Administrator's expenses will generally be derived by multiplying our Administrator's total expenses by the approximate percentage of time the Administrator's employees perform services for us in relation to their time spent performing services for all companies serviced by our Administrator under contractual agreements. Management believes that the new methodology of allocating the Administrator's total expenses by approximate percentage of time services were performed among all companies serviced by our Administrator more closely approximates fees paid to actual services performed.

### **Critical Accounting Policies**

The preparation of our financial statements in accordance with Generally Accepted Accounting Principles in the U.S., or GAAP, requires management to make judgments that are subjective in nature in order to make certain estimates and assumptions. 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. There were no material changes to our critical accounting policies during the year ended December 31, 2014.

### *Allocation of Purchase Price*

When we acquire real estate, we allocate the purchase price to (i) the acquired tangible assets and liabilities, consisting of land, building, tenant improvements and long-term debt and (ii) the identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, in-place leases, unamortized lease origination costs, tenant relationships and capital lease obligations, based in each case on their fair values in accordance with ASC 805, Business Combinations. All expenses related to the acquisition are expensed as incurred.

Our Adviser estimates value 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. Our Adviser also considers 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

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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. Our Adviser 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. Our Adviser 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:

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, our Adviser considers such factors as our tenants' payment histories, the financial condition of our tenants, including calculating the current leverage ratios of tenants, the likelihood of lease renewal, business conditions in the industries in which our tenants operate and whether the carrying value of our real estate has decreased. If any of the factors above indicate 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 of 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 were 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, we evaluated our entire portfolio as of December 31, 2014, for any impairment indicators and performed an impairment analysis on those select properties that had an indication of impairment. We concluded that our Roseville, Minnesota property was impaired as of March 31, 2014. We determined that the expected undiscounted cash flows, based upon a revised estimated holding period of this property, were below the current carrying value. The estimated holding period was revised after a potential tenant that we were anticipating to lease a large portion of the vacant space, during the three months ended March 31, 2014, did not execute a lease on the property. Consequently, we revised

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the holding period to coincide with maturity of the mortgage loan on the property in June 2014. Accordingly, we reduced the carrying value of this property to its estimated fair value, less cost to sell, and we recognized an impairment loss of \$14.2 million during the year ended December 31, 2014. This property was returned to the lender in a deed-in-lieu transaction on November 12, 2014.

We had previously reported that our property located in South Hadley, Massachusetts was at risk of becoming impaired in the future. The existing tenant extended the lease on the property for two years, and it will now expire in January 2017. Because of this lease extension, we are no longer at risk of having to impair this property in fiscal year 2015.

We will continue to monitor our portfolio for any other indicators of impairment. There have been no other impairments recognized on our real estate assets since inception.

## **Results of Operations**

The weighted-average yield on our total portfolio, which was 8.7% as of December 31, 2014, is calculated by taking the annualized straight-line rents, reflected as rental income on our consolidated statements of operations, of each acquisition as a percentage of the acquisition cost. The weighted-average yield does not account for the interest expense incurred on the mortgages placed on our properties.

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A comparison of our operating results for the years ended December 31, 2014 and 2013 is below (dollars in thousands, except per share amounts):

|   | For the year ended December 31, |                 |                |              |
|---|---------------------------------|-----------------|----------------|--------------|
|   | 2014                            | 2013            | \$<br>Change   | % Change     |
| <b>Operating revenues</b>   |                                 |                 |                |              |
| Rental revenue  | \$ 71,211                       | \$ 59,769       | \$ 11,442      | 19%          |
| Tenant recovery revenue   | 2,079                           | 1,574           | 505            | 32           |
| Interest income from mortgage note receivable                                 | 466                             |                 | 466            | NM           |
| <b>Total operating revenues</b>   | <b>73,756</b>                   | <b>61,343</b>   | <b>12,413</b>  | <b>20</b>    |
| <b>Operating expenses</b>   |                                 |                 |                |              |
| Depreciation and amortization   | 28,864                          | 22,827          | 6,037          | 26           |
| Property operating expenses   | 4,711                           | 3,348           | 1,363          | 41           |
| Acquisition related expenses  | 1,438                           | 768             | 670            | 87           |
| Base management fee   | 2,798                           | 2,014           | 784            | 39           |
| Incentive fee   | 4,305                           | 4,201           | 104            | 2            |
| Administration fee  | 1,526                           | 1,467           | 59             | 4            |
| General and administrative  | 2,689                           | 1,655           | 1,034          | 62           |
| Impairment charge   | 14,238                          |                 | 14,238         | NM           |
| <b>Total operating expenses before credit to incentive fee</b>                | <b>60,569</b>                   | <b>36,280</b>   | <b>24,289</b>  | <b>67</b>    |
| Credit to base management fee   | (150)                           |                 | (150)          | NM           |
| Credit to incentive fee   | (3,013)                         | (3,457)         | 444            | (13)         |
| <b>Total operating expenses</b>   | <b>57,406</b>                   | <b>32,823</b>   | <b>24,583</b>  | <b>75</b>    |
| <b>Other income (expense)</b>   |                                 |                 |                |              |
| Interest expense  | (26,197)                        | (24,351)        | (1,846)        | 8            |
| Distributions attributable to Series C mandatorily redeemable preferred stock | (2,743)                         | (2,743)         |                |              |
| Gain on sale of real estate   | 1,240                           |                 | 1,240          | NM           |
| Gain on debt extinguishment   | 5,274                           |                 | 5,274          | NM           |
| Other income  | 174                             | 101             | 73             | 72           |
| <b>Total other expense</b>  | <b>(22,252)</b>                 | <b>(26,993)</b> | <b>4,741</b>   | <b>(18)</b>  |
| <b>Net (loss) income</b>  | <b>(5,902)</b>                  | <b>1,527</b>    | <b>(7,429)</b> | <b>(487)</b> |
| <b>Distributions attributable to Series A and B preferred stock</b>           | <b>(4,094)</b>                  | <b>(4,094)</b>  |                |              |
| Distributions attributable to senior common stock                             | (542)                           | (300)           | (242)          | 81           |

|   |             |            |            |     |
|---|-------------|------------|------------|-----|
| Net loss attributable to common stockholders  | \$ (10,538) | \$ (2,867) | \$ (7,671) | 268 |
| Net loss attributable to common stockholders per weighted average share of common stock - diluted | \$ (0.61)   | \$ (0.22)  | \$ (0.39)  | 179 |
| FFO available to common stockholders  | \$ 31,324   | \$ 19,960  | \$ 11,364  | 57  |
| FFO per weighted average share of common stock - diluted  | \$ 1.77     | \$ 1.49    | \$ 0.28    | 19  |

NM = Not meaningful

### *Operating Revenues*

Rental income increased for the year ended December 31, 2014, as compared to the year ended December 31, 2013, because of the 11 properties acquired during 2014, partially offset by a loss of approximately \$1.1 million of rental income due to vacancies and property sales in our portfolio during 2014.

Tenant recovery revenue increased for the year ended December 31, 2014, as compared to the year ended December 31, 2013. This increase was primarily due to operating expense recoveries from nine tenants in properties acquired in 2014 that are subject to a base year or gross lease.

Interest income from mortgage note receivable increased for the year ended December 31, 2014, as compared to the year ended December 31, 2013, because of interest earned on the mortgage loan issued in July 2014 that was not outstanding during 2013.

### *Operating Expenses*

Depreciation and amortization expenses increased for the year ended December 31, 2014, as compared to the year ended December 31, 2013, because of the 11 properties acquired during 2014 and a full year of depreciation for properties acquired in 2013.

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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 for the year ended December 31, 2014, as compared to the year ended December 31, 2013, primarily because of an increase in overhead (maintenance, repair and utilities) expenses at our vacant properties, coupled with expenses at certain properties acquired during 2014 that are subject to a base year or gross lease.

Acquisition related 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. Acquisition related expense increased for the year ended December 31, 2014, as compared to the year ended December 31, 2013, as a result of acquiring 11 properties during 2014, as compared to 7 properties during 2013.

The base management fee increased for the year ended December 31, 2014, as compared to the year ended December 31, 2013, due to an increase in total common stockholders' equity, the main component of the calculation, partially offset by a credit to the base management fee received during the year ended December 31, 2014 related to an advisory fee received by our Advisor from one of our tenants. The calculation of the base management fee is described in detail above under *Advisory and Administration Agreements*.

The incentive fee increased slightly for the year ended December 31, 2014, as compared to the year ended December 31, 2013, because of an increase in pre-incentive fee FFO. The increase in pre-incentive fee FFO was due to an increase in rental revenues from the properties acquired during 2014, which was partially offset by an increase in property operating and interest expenses during the year ended December 31, 2014, as compared to the year ended December 31, 2013; however this was partially offset by no incentive fee being recorded during the fourth quarter of 2014 because of the realization of the loss related to the Roseville, Minnesota property. The incentive fee credit decreased for the year ended December 31, 2014, as compared to the year ended December 31, 2013, because of an increase in total operating revenues from the properties acquired in the past year partially offset by the amount of common distributions paid on the shares issued during the past year coupled with higher expenses at our vacant properties. The calculation of the incentive fee is described in detail above within *Advisory and Administration Agreements*.

The administration fee increased slightly for the year ended December 31, 2014, as compared to the year ended December 31, 2013. The increase was primarily from an increase in the amount of the fee allocated to us by our Administrator during the first half of 2014; however, in July 2014, the allocation of the fee was revised such that the fee is generally now based upon the percentage of time employees of the Administrator spend on our matters in relation to time spent on other funds contractually managed by our Administrator versus the prior methodology whereby we were generally allocated the fee based upon our total assets in relation to other funds managed by our Administrator. We anticipate our future administration fees to be lower under the new methodology. The calculation of the administration fee is described in detail above within *Advisory and Administration Agreements*.

General and administrative expenses increased for the year ended December 31, 2014, as compared to the year ended December 31, 2013, as a result of an increase in professional fees from the increase in our portfolio coupled with the write off of \$0.8 million of the deferred rent asset associated with our property located in Concord Township, Ohio.

The impairment charge is a result of the impairment of our Roseville, Minnesota property. We did not recognize an impairment charge during the year ended December 31, 2013.

### *Other Income and Expenses*

Interest expense increased for the year ended December 31, 2014, as compared to the year ended December 31, 2013. This increase was primarily a result of interest on the \$62.2 million of mortgage debt assumed and issued during 2014, partially offset by reduced interest expense on our long-term financings from amortizing and balloon principal payments made during 2014.

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The gain on sale of real estate is a result of our property we sold located in Sterling Heights, Michigan in June 2014.

The gain on debt extinguishment is a result of the deed-in-lieu transaction related to our Roseville, Minnesota property that was completed in November 2014. The outstanding debt on the property that was deemed satisfied in exchange for the property was in excess of the carrying value of the property. We did not recognize a gain on debt extinguishment during the year ended December 31, 2013.

Other income increased during the year ended December 31, 2014, as compared to the year ended December 31, 2013, because of an increase in management fees collected from certain of our tenants.

*Net Loss Available to Common Stockholders*

Net loss available to common stockholders increased for the year ended December 31, 2014, as compared to the year ended December 31, 2013, primarily because of the realized loss from the Roseville, Minnesota property coupled with increased interest expense, property operating expenses, depreciation expense, partially offset by an increase in rental income earned from the 11 properties acquired during 2014 and the gain on sale of real estate.

*A comparison of our operating results for the years ended December 31, 2013 and 2012 is below (dollars in thousands, except per share amounts):*

|  | For the year ended December 31, |               |               |            |
|--|---------------------------------|---------------|---------------|------------|
|  | 2013                            | 2012          | \$<br>Change  | % Change   |
| <b>Operating revenues</b>                                      |                                 |               |               |            |
| Rental income  | \$ 59,769                       | \$ 50,915     | \$ 8,854      | 17%        |
| Tenant recovery revenue  | 1,574                           | 355           | 1,219         | 343%       |
| <b>Total operating revenues</b>                                | <b>61,343</b>                   | <b>51,270</b> | <b>10,073</b> | <b>20%</b> |
| <b>Operating expenses</b>                                      |                                 |               |               |            |
| Depreciation and amortization                                  | 22,827                          | 16,831        | 5,996         | 36%        |
| Property operating expenses                                    | 3,348                           | 1,588         | 1,760         | 111%       |
| Acquisition related expense                                    | 768                             | 949           | (181)         | -19%       |
| Base management fee  | 2,014                           | 1,467         | 547           | 37%        |
| Incentive fee  | 4,201                           | 3,569         | 632           | 18%        |
| Administration fee   | 1,467                           | 1,118         | 349           | 31%        |
| General and administrative                                     | 1,655                           | 1,594         | 61            | 4%         |
| <b>Total operating expenses before credit to incentive fee</b> | <b>36,280</b>                   | <b>27,116</b> | <b>9,164</b>  | <b>34%</b> |
| Credit to incentive fee  | (3,457)                         | (2,221)       | (1,236)       | 56%        |
| <b>Total operating expenses</b>                                | <b>32,823</b>                   | <b>24,895</b> | <b>7,928</b>  | <b>32%</b> |
| Other income (expense)   |                                 |               |               |            |

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|  |            |           |            |      |
|--|------------|-----------|------------|------|
| Interest expense   | (24,351)   | (20,226)  | (4,125)    | 20%  |
| Distributions attributable to Series C mandatorily redeemable preferred stock                  | (2,743)    | (2,515)   | (228)      | 9%   |
| Other income   | 101        | 127       | (26)       | -20% |
| Total other expense  | (26,993)   | (22,614)  | (4,379)    | 19%  |
| Net income   | 1,527      | 3,761     | (2,234)    | -59% |
| Distributions attributable to Series A and B preferred stock                                   | (4,094)    | (4,093)   | (1)        | 0%   |
| Distributions attributable to senior common stock  | (300)      | (113)     | (187)      | 165% |
| Net loss available to common stockholders  | \$ (2,867) | \$ (445)  | \$ (2,422) | 544% |
| Net loss available to common stockholders per weighted average share of common stock - diluted | \$ (0.22)  | \$ (0.04) | \$ (0.18)  | 450% |
| FFO available to common stockholders   | \$ 19,960  | \$ 16,386 | \$ 3,574   | 22%  |
| FFO per weighted average share of common stock - diluted                                       | \$ 1.49    | \$ 1.48   | \$ 0.01    | 1%   |

*Operating Revenues*

Rental income increased for the year ended December 31, 2013, as compared to the year ended December 31, 2012, because of the seven properties acquired during 2013, partially offset by a loss of rental income due to vacancies in our portfolio during 2013.

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Tenant recovery revenue increased for the year ended December 31, 2013, as compared to the year ended December 31, 2012. This increase was primarily due to reimbursements from our tenant in our partially vacant building located in Roseville, Minnesota.

### *Operating Expenses*

Depreciation and amortization expenses increased for the year ended December 31, 2013, as compared to the year ended December 31, 2012, because of the seven properties acquired during 2013 and a full year of depreciation for properties acquired in 2012.

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 for the year ended December 31, 2013, as compared to the year ended December 31, 2012, primarily because of an increase in overhead (maintenance, repair and utilities) expenses at our partially vacant Roseville, Minnesota building.

Acquisition related 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. Acquisition related expense decreased for the year ended December 31, 2013, as compared to the year ended December 31, 2012, as a result of acquiring only seven properties during 2013, as compared to eight properties during 2012.

The base management fee increased for the year ended December 31, 2013, as compared to the year ended December 31, 2012, due to an increase in total common stockholders' equity, the main component of the calculation. 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, 2013, as compared to the year ended December 31, 2012, because of an increase in pre-incentive fee FFO. The increase in pre-incentive fee FFO was due to an increase in rental revenues from the properties acquired during 2013, which was partially offset by an increase in property operating and interest expenses during the year ended December 31, 2013, as compared to the year ended December 31, 2012.

The incentive fee credit increased for the year ended December 31, 2013, as compared to the year ended December 31, 2012, because of an increase in the amount of common distributions paid from the shares issued during 2013. The calculation of the incentive fee is described in detail above within *Advisory and Administration Agreements*.

The administration fee increased for the year ended December 31, 2013, as compared to the year ended December 31, 2012, as a result of an increase in the amount of the total expenses our Administrator incurred during 2013, coupled with a larger percentage of the fee being allocated to us as a result of the increase in our total assets during 2013. The calculation of the administration fee is described in detail above within *Advisory and Administration Agreements*.

General and administrative expenses increased for the year ended December 31, 2013, as compared to the year ended December 31, 2012, as a result of an increase in professional fees related to tax and audit services from the increase in our portfolio.

### *Other Income and Expenses*

Interest expense increased for the year ended December 31, 2013, as compared to the year ended December 31, 2012. This increase was primarily a result of interest on the \$80.0 million of mortgage debt assumed and issued during 2013, partially offset by reduced interest expense on our long-term financings from amortizing and balloon principal payments made during 2013.

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Distributions for our mandatorily redeemable preferred stock increased for the year ended December 31, 2013, as compared to the year ended December 31, 2012, because the public offering of shares of our 7.125% Series C Cumulative Term Preferred stock, or Term Preferred Stock, was completed in February 2012, and thus was not outstanding for the full year ended December 31, 2012.

Other income decreased during the year ended December 31, 2013, as compared to the year ended December 31, 2012, because of lower interest income on employee loans earned during 2013, as compared to 2012 due to principal repayments made by employees of our Adviser during 2013.

### *Net Loss Available to Common Stockholders*

Net loss available to common stockholders increased for the year ended December 31, 2013, as compared to the year ended December 31, 2012, primarily because of increased interest expense, property operating expenses, depreciation expense and increased distributions to our preferred stockholders from the issuance of our Term Preferred Stock, partially offset by an increase in rental income earned from the seven properties acquired during 2013.

## **Liquidity and Capital Resources**

### *Overview*

Our sources of liquidity include cash flows from operations, cash and cash equivalents, borrowings under our Line of Credit, obtaining mortgages on our unencumbered properties and issuing additional equity securities. Our available liquidity at December 31, 2014, was \$17.9 million, including \$8.6 million in cash and cash equivalents and an available borrowing capacity of \$9.3 million under our Line of Credit. Our available borrowing capacity under the Line of Credit has increased to \$28.3 million since the end of the year.

### *Future Capital Needs*

We actively seek conservative investments that are likely to produce income to pay distributions to our stockholders. We intend to use the proceeds received from future equity raised and debt capital borrowed to continue to invest in industrial, commercial and retail real property, make mortgage loans, or pay down outstanding borrowings under our 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 service costs on our existing long-term mortgages and on borrowings under our Line of Credit, 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 available liquidity is sufficient to fund our distributions to stockholders, pay the debt service costs on our existing long-term mortgages and borrowings under our Line of Credit and fund our current operating costs in the near term. Additionally, to satisfy our short-term obligations, we may request 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. Historically, our Adviser has provided such partial credits to our management fees on a quarterly basis. We further believe that our cash flow from operations coupled with the financing capital available to us in the future are sufficient to fund our long-term liquidity needs.

### *Equity Capital*

During 2014, we raised net proceeds of \$26.0 million in common equity in an underwritten follow-on public offering, at a share price of \$17.00. We also raised net proceeds of \$7.6 million of common equity under our Prior ATM with Jefferies, at an average share price of \$17.47, and net proceeds of \$32.0 million of common equity under our New ATM with Cantor Fitzgerald at an average share price of \$17.35. Furthermore, we raised \$5.6 million in net proceeds of senior common equity, net of \$0.2 million of investor redemptions. We used these proceeds to acquire additional real estate and for general corporate purposes.

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As of February 18, 2015, we have the ability to raise up to \$185.7 million of additional equity capital through the sale and issuance of securities that are registered under our universal shelf registration statement on Form S-3 (File No. 333-190931), or the Universal Shelf, in one or more future public offerings. Of the \$185.7 million of available capacity under our Universal Shelf, \$54.0 million of common stock is reserved for additional sales under our New ATM and \$40.9 million is reserved for sales of our Senior Common Stock. Our Senior Common Stock offering will terminate on March 28, 2015. We believe that our ATM program is a sufficient source of liquidity for 2015, and our Senior Common Stock offerings will not materially impact our 2015 acquisitions.

### *Debt Capital*

As of December 31, 2014, we had mortgage notes payable in the aggregate principal amount of \$459.3 million, collateralized by a total of 77 properties with terms at issuance ranging from 4 years to 25 years. The weighted-average interest rate on the mortgage notes payable as of December 31, 2014 was 5.3%.

The CMBS market has recovered from the recent recession; see the discussion in *Business Environment* above. Specifically, we continue to see banks and other non-bank lenders willing to issue 10-year mortgages. Consequently, we are focused on obtaining mortgages through regional banks, non-bank lenders and the CMBS market.

We have mortgage debt in the aggregate principal amount of \$42.4 million payable during 2015 and \$99.0 million payable during 2016. The 2015 principal amounts payable include both amortizing principal payments and 3 balloon principal payments due in the second half of the year. We anticipate being able to refinance the mortgages that come due during 2015 and 2016 with a combination of new mortgage debt and additional equity.

### *Operating Activities*

Net cash provided by operating activities during the year ended December 31, 2014, was \$28.2 million, as compared to net cash provided by operating activities of \$19.9 million for the year ended December 31, 2013. This increase was primarily a result of an increase in rental income received from the properties acquired during 2014, partially offset by the loss of rental income from vacancies in our portfolio and property operating expenses we are responsible for at certain of our vacant properties. 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 used in investing activities during the year ended December 31, 2014, was \$130.4 million, which primarily consisted of the acquisition of 11 properties, the expansion at another property and tenant improvements performed at certain of our properties, partially offset by the proceeds from the sale of a property during the year ended December 31, 2014, as compared to net cash used in investing activities during the year ended December 31, 2013, of \$137.1 million, which primarily consisted of the acquisition of seven properties, and the expansion at another property coupled with tenant improvements performed at certain of our properties.

### *Financing Activities*

Net cash provided by financing activities during the year ended December 31, 2014, was \$102.3 million, which primarily consisted of proceeds from the sale of common stock, borrowings under our Line of Credit and proceeds from the issuance of mortgage notes payable, partially offset by the increase in distributions



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paid to our stockholders and principal repayments on mortgage notes payable. Net cash provided by financing activities for the year ended December 31, 2013, was \$120.2 million, which primarily consisted of proceeds from the sale of common stock and proceeds from the issuance of mortgage notes payable, partially offset by the increase in distributions paid to our stockholders and principal repayments on mortgage notes payable.

*Line of Credit*

In August 2013, we procured our \$60.0 million Line of Credit, expanded to \$75.0 million in November 2014, with KeyBank National Association (serving as a revolving lender, a letter of credit issuer and an administrative agent) and added Citizens Bank of Pennsylvania as an additional lender. Comerica Bank was subsequently added as another lender in December 2013. In March 2014, we amended our Line of Credit to extend the maturity date by one year to August 2017. We also modified certain terms under the Line of Credit, including the calculation of the total asset value and unencumbered asset value. The applicable LIBOR margins were also reduced 25 basis points at each pricing level. As a result of these modifications, the availability under our Line of Credit increased by \$1.3 million.

The Line of Credit initially matures in August 2017; however, we have a one-year extension option subject to the payment of an extension fee equal to 25 basis points on the initial maturity date and certain other customary conditions.

The Line of Credit has a letter of credit sublimit of up to \$20.0 million. In addition, we may expand the Line of Credit up to a total of \$100.0 million upon satisfaction of certain conditions and payment of the associated up front and arrangement fees at the time of such increase. The interest rate per annum applicable to the Line of Credit is equal to the London Interbank Offered Rate, or LIBOR, plus an applicable margin of up to 3.25%, depending upon our leverage. The leverage ratio used in determining the applicable margin for interest on the Line of Credit is recalculated quarterly. We are subject to an annual maintenance fee of \$0.03 million per year and an unused commitment fee of 25 basis points per year, which accrues quarterly. 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 100% of our FFO, with acquisition-related costs required to be expensed under ASC 805 added back to FFO. In addition, the maximum amount we may draw under the Line of Credit is based on a percentage of the value of a pool of unencumbered properties, which must meet agreed upon eligibility standards.

If and when long-term mortgages are arranged for properties in the unencumbered pool, the banks will reduce the availability under the Line of Credit by the amount advanced against that property's value. Conversely, as we purchase new properties meeting the eligibility standards, we may add these new properties to the unencumbered pool to obtain additional availability under the Line of Credit. The availability under the Line of Credit is also 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.

As of December 31, 2014, there was \$43.3 million outstanding under our Line of Credit at an interest rate of approximately 3.17% and \$4.5 million outstanding under letters of credit at a weighted average interest rate of 3.0%. As of February 18, 2015, the maximum additional amount we could draw was \$28.3 million. We were in compliance with all covenants under the Line of Credit as of December 31, 2014.

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

The following table reflects our material contractual obligations as of December 31, 2014 (in thousands):

| Contractual Obligations                     | Total             | Payments Due by Period |                   |                  |                   |
|---|-------------------|------------------------|-------------------|------------------|-------------------|
|   |                   | Less than 1 Year       | 1-3 Years         | 3-5 Years        | More than 5 Years |
| Debt Obligations <sup>(1)</sup>             | \$ 540,392        | \$ 42,436              | \$ 248,495        | \$ 55,196        | \$ 194,265        |
| Interest on Debt Obligations <sup>(2)</sup> | 120,258           | 26,617                 | 38,560            | 22,982           | 32,099            |
| Operating Lease Obligations <sup>(3)</sup>  | 6,685             | 429                    | 861               | 866              | 4,529             |
| Purchase Obligations <sup>(4)</sup>         | 5,331             | 5,331                  |                   |                  |                   |
| <b>Total</b>                                | <b>\$ 672,666</b> | <b>\$ 74,813</b>       | <b>\$ 287,916</b> | <b>\$ 79,044</b> | <b>\$ 230,893</b> |

- (1) Debt obligations represent borrowings under our Line of Credit, which represents \$43.3 million of the debt obligation due in 2017, mortgage notes payable that were outstanding as of December 31, 2014, and amounts due to the holders of our Term Preferred Stock.
- (2) Interest on debt obligations includes estimated interest on our borrowings under our Line of Credit, mortgage notes payable and interest due to the holders of our Term Preferred Stock. 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, 2014.
- (3) Operating lease obligations represent the ground lease payments due on our Tulsa, Oklahoma, Dartmouth, Massachusetts, and Springfield, Missouri properties.
- (4) Purchase obligations consist of \$1.2 million to fund tenant improvements at two of our Ohio properties, \$2.8 million in tenant improvements at our Burnsville, MN property, \$0.8 million of tenant improvements at our Austin, TX property, and \$0.5 million of tenant improvements at our Bolingbrook, IL property. These items were recognized on our balance sheet for the year ended December 31, 2014

**Off-Balance Sheet Arrangements**

We did not have any off-balance sheet arrangements as of December 31, 2014.

**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 indices, and the interest rate on our 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. To that end, we have entered into a derivative contract with Wells Fargo to cap interest rates for the variable rate note payable on our Champaign, Illinois property. We paid a fee of \$0.03 million to cap LIBOR rates at 3.0%, to limit our exposure to interest rates on this note payable.

To illustrate the potential impact of changes in interest rates on our net income for the year ended December 31, 2014, 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 annual impact of a 1%, 2% and 3% increase in the one month LIBOR as of December 31, 2014. As of December 31, 2014, our effective average LIBOR was 0.17%; thus, a 1%, 2% or 3% decrease could not occur.

| Interest Rate Change | (Dollars in Thousands)       |                            |
|----------------------|------------------------------|----------------------------|
|                      | Increase to Interest Expense | Net Decrease to Net Income |
| 1% Increase to LIBOR | \$ 522                       | \$ (522)                   |
| 2% Increase to LIBOR | 1,044                        | (1,044)                    |
| 3% Increase to LIBOR | 1,525                        | (1,525)                    |

As of December 31, 2014, the fair value of our mortgage debt outstanding was \$476.9 million. Interest rate fluctuations may affect the fair value of our debt instruments. If interest rates on our debt instruments, using rates at December 31, 2014, had been one percentage point higher or lower, the fair value of those debt instruments on that date would have decreased or increased by \$26.3 million and \$11.0 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 these objectives, 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.

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**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 (2013)* 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, 2014.

The effectiveness of our internal control over financial reporting as of December 31, 2014 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

February 18, 2015

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**Report of Independent Registered Public Accounting Firm**

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity, and cash flows present fairly, in all material respects, the financial position of Gladstone Commercial Corporation and its subsidiaries at December 31, 2014 and December 31, 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014 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, 2014, based on criteria established in *Internal Control - Integrated Framework (2013)* 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 on Internal Controls over Financial Reporting. 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.

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.

PricewaterhouseCoopers LLP

McLean, Virginia

February 18, 2015

**Table of Contents****Gladstone Commercial Corporation****Consolidated Balance Sheets****(Dollars in Thousands, Except Share and Per Share Data)**

|  | December 31, 2014 | December 31, 2013 |
|--|-------------------|-------------------|
| <b>ASSETS</b>  |                   |                   |
| Real estate, at cost   | \$ 722,565        | \$ 642,353        |
| Less: accumulated depreciation   | 92,133            | 81,241            |
| Total real estate, net   | 630,432           | 561,112           |
| Lease intangibles, net   | 98,814            | 79,632            |
| Mortgage note receivable   | 5,600             |                   |
| Cash and cash equivalents  | 8,599             | 8,546             |
| Restricted cash  | 3,547             | 5,051             |
| Funds held in escrow   | 11,096            | 8,653             |
| Deferred rent receivable, net  | 21,728            | 18,905            |
| Deferred financing costs, net  | 6,213             | 6,840             |
| Other assets   | 1,765             | 1,786             |
| <b>TOTAL ASSETS</b>  | <b>\$ 787,794</b> | <b>\$ 690,525</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                   |                   |
| <b>LIABILITIES</b>   |                   |                   |
| Mortgage notes payable   | \$ 459,299        | \$ 422,602        |
| Borrowings under line of credit  | 43,300            | 24,400            |
| Series C mandatorily redeemable preferred stock, par value \$0.001 per share; \$25 per share liquidation preference; 1,700,000 shares authorized; and 1,540,000 shares issued and outstanding at December 31, 2014 and December 31, 2013, respectively | 38,500            | 38,500            |
| Deferred rent liability, net   | 8,594             | 6,015             |
| Asset retirement obligation  | 3,616             | 3,884             |
| Accounts payable and accrued expenses  | 8,285             | 2,359             |
| Due to Adviser and Administrator <sup>(1)</sup>  | 916               | 1,360             |
| Other liabilities  | 7,612             | 8,259             |
| Total Liabilities  | \$ 570,122        | \$ 507,379        |
| Commitments and contingencies <sup>(2)</sup>   |                   |                   |
| <b>STOCKHOLDERS EQUITY</b>   |                   |                   |
| Series A and B redeemable preferred stock, par value \$0.001 per share; \$25 per share liquidation preference; 2,300,000 shares authorized and 2,150,000 shares issued and outstanding at  | \$ 2              | \$ 2              |

|  |                   |                   |
|--|-------------------|-------------------|
| December 31, 2014 and December 31, 2013, respectively  |                   |                   |
| Senior common stock, par value \$0.001 per share; 7,500,000 shares authorized and 809,411 and 374,484 shares issued and outstanding at December 31, 2014 and December 31, 2013, respectively | 1                 |                   |
| Common stock, par value \$0.001 per share, 38,500,000 shares authorized and 19,589,606 and 15,662,414 shares issued and outstanding at December 31, 2014 and December 31, 2013, respectively | 20                | 16                |
| Additional paid in capital   | 369,748           | 298,751           |
| Notes receivable - employee  | (375)             | (375)             |
| Distributions in excess of accumulated earnings  | (151,724)         | (115,248)         |
| <b>Total Stockholders Equity</b>   | <b>217,672</b>    | <b>183,146</b>    |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>   | <b>\$ 787,794</b> | <b>\$ 690,525</b> |

(1) Refer to Note 2 Related-Party Transactions

(2) Refer to Note 9 Commitments and Contingencies

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

**Table of Contents****Gladstone Commercial Corporation****Consolidated Statements of Operations****(Dollars in Thousands, Except Per Share Data)**

|   | For the year ended December 31, |                 |                 |
|---|---------------------------------|-----------------|-----------------|
|   | 2014                            | 2013            | 2012            |
| Operating revenues  |                                 |                 |                 |
| Rental revenue  | \$ 71,211                       | \$ 59,769       | \$ 50,915       |
| Tenant recovery revenue   | 2,079                           | 1,574           | 355             |
| Interest income from mortgage note receivable                                 | 466                             |                 |                 |
| <b>Total operating revenues</b>   | <b>73,756</b>                   | <b>61,343</b>   | <b>51,270</b>   |
| Operating expenses  |                                 |                 |                 |
| Depreciation and amortization   | 28,864                          | 22,827          | 16,831          |
| Property operating expenses   | 4,711                           | 3,348           | 1,588           |
| Acquisition related expenses  | 1,438                           | 768             | 949             |
| Base management fee <sup>(1)</sup>  | 2,798                           | 2,014           | 1,467           |
| Incentive fee <sup>(1)</sup>  | 4,305                           | 4,201           | 3,569           |
| Administration fee <sup>(1)</sup>   | 1,526                           | 1,467           | 1,118           |
| General and administrative  | 2,689                           | 1,655           | 1,594           |
| Impairment charge   | 14,238                          |                 |                 |
| <b>Total operating expenses before credit to incentive fee</b>                | <b>60,569</b>                   | <b>36,280</b>   | <b>27,116</b>   |
| Credit to base management fee <sup>(1)</sup>                                  | (150)                           |                 |                 |
| Credit to incentive fee <sup>(1)</sup>  | (3,013)                         | (3,457)         | (2,221)         |
| <b>Total operating expenses</b>   | <b>57,406</b>                   | <b>32,823</b>   | <b>24,895</b>   |
| Other income (expense)  |                                 |                 |                 |
| Interest expense  | (26,197)                        | (24,351)        | (20,226)        |
| Distributions attributable to Series C mandatorily redeemable preferred stock | (2,743)                         | (2,743)         | (2,515)         |
| Gain on sale of real estate   | 1,240                           |                 |                 |
| Gain on debt extinguishment   | 5,274                           |                 |                 |
| Other income  | 174                             | 101             | 127             |
| <b>Total other expense</b>  | <b>(22,252)</b>                 | <b>(26,993)</b> | <b>(22,614)</b> |
| <b>Net (loss) income</b>  | <b>(5,902)</b>                  | <b>1,527</b>    | <b>3,761</b>    |
| Distributions attributable to Series A and B preferred stock                  | (4,094)                         | (4,094)         | (4,093)         |
| Distributions attributable to senior common stock                             | (542)                           | (300)           | (113)           |

|  |             |            |            |
|--|-------------|------------|------------|
| Net loss attributable to common stockholders                       | \$ (10,538) | \$ (2,867) | \$ (445)   |
| Loss per weighted average share of common stock - basic & diluted  |             |            |            |
| Loss attributable to common shareholders                           | \$ (0.61)   | \$ (0.22)  | \$ (0.04)  |
| Weighted average shares of common stock outstanding                |             |            |            |
| Basic and Diluted  | 17,253,503  | 13,164,244 | 10,953,325 |
| Earnings per weighted average share of senior common stock         | \$ 1.05     | \$ 1.04    | \$ 1.06    |
| Weighted average shares of senior common stock outstanding - basic | 516,937     | 287,178    | 106,271    |

(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****(Dollars in Thousands)**

|  | Preferred<br>Stock | Shares Issued<br>Senior<br>Common<br>Stock | Common<br>Stock | Preferred<br>Stock | Senior<br>Common<br>Stock | Common<br>Stock | Additional<br>Paid in<br>Capital | Notes<br>Receivable<br>from Employees | Distributions in<br>Excess of<br>Accumulated<br>Earnings | Total<br>Stockholders'<br>Equity |
|--|--------------------|--|-----------------|--------------------|---------------------------|-----------------|----------------------------------|---------------------------------------|--|----------------------------------|
| Balance at<br>December 31,<br>2011   | 2,150,000          | 60,290                                     | 10,945,379      | \$ 2               | \$                        | \$ 11           | \$ 211,553                       | \$ (422)                              | \$ (75,830)  | \$ 135,314                       |
| Issuance of<br>senior<br>common stock<br>and common<br>stock, net                            |                    | 119,221                                    | 138,205         |                    |                           |                 | 3,917                            |                                       |  | 3,917                            |
| Repayment of<br>principal on<br>employee<br>notes<br>receivable                              |                    |  |                 |                    |                           |                 |                                  | 12                                    |  | 12                               |
| Distributions<br>declared to<br>common,<br>senior<br>common and<br>preferred<br>stockholders |                    |  |                 |                    |                           |                 |                                  |                                       | (20,639)   | (20,639)                         |
| Net income   |                    |  |                 |                    |                           |                 |                                  |                                       | 3,761  | 3,761                            |
| Balance at<br>December 31,<br>2012   | 2,150,000          | 179,511                                    | 11,083,584      | \$ 2               | \$                        | \$ 11           | \$ 215,470                       | \$ (410)                              | \$ (92,708)  | \$ 122,365                       |
| Issuance of<br>senior<br>common stock<br>and common<br>stock, net                            |                    | 194,973                                    | 4,578,830       |                    |                           | 5               | 83,281                           |                                       |  | 83,286                           |
| Repayment of<br>principal on<br>employee<br>notes  |                    |  |                 |                    |                           |                 |                                  | 35                                    |  | 35                               |

|  |           |         |            |      |      |       |            |          |              |          |            |
|--|-----------|---------|------------|------|------|-------|------------|----------|--------------|----------|------------|
| receivable   |           |         |            |      |      |       |            |          |              |          |            |
| Distributions declared to common, senior common and preferred stockholders |           |         |            |      |      |       |            |          |              | (24,067) | (24,067)   |
| Net income   |           |         |            |      |      |       |            |          |              | 1,527    | 1,527      |
| Balance at December 31, 2013   | 2,150,000 | 374,484 | 15,662,414 | \$ 2 | \$   | \$ 16 | \$ 298,751 | \$ (375) | \$ (115,248) | \$       | \$ 183,146 |
| Issuance of senior common stock and common stock, net                      |           | 434,927 | 3,927,192  |      | 1    | 4     | 70,997     |          |              |          | 71,002     |
| Distributions declared to common, senior common and preferred stockholders |           |         |            |      |      |       |            |          |              | (30,574) | (30,574)   |
| Net loss   |           |         |            |      |      |       |            |          |              | (5,902)  | (5,902)    |
| Balance at December 31, 2014   | 2,150,000 | 809,411 | 19,589,606 | \$ 2 | \$ 1 | \$ 20 | \$ 369,748 | \$ (375) | \$ (151,724) | \$       | \$ 217,672 |

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

**Table of Contents****Gladstone Commercial Corporation****Consolidated Statements of Cash Flows****(Dollars in Thousands)**

|   | For the year ended December 31, |                  |                 |
|---|---------------------------------|------------------|-----------------|
|   | 2014                            | 2013             | 2012            |
| <b>Cash flows from operating activities:</b>  |                                 |                  |                 |
| Net (loss) income   | \$ (5,902)                      | \$ 1,527         | \$ 3,761        |
| <b>Adjustments to reconcile net (loss) income to net cash provided by operating activities:</b>     |                                 |                  |                 |
| Depreciation and amortization   | 28,864                          | 22,827           | 16,831          |
| Impairment charge   | 14,238                          |                  |                 |
| Gain on debt extinguishment   | (5,274)                         |                  |                 |
| Gain on sale of real estate   | (1,240)                         |                  |                 |
| Amortization of deferred financing costs  | 1,656                           | 1,780            | 1,502           |
| Amortization of deferred rent asset and liability, net  | (389)                           | (333)            | (772)           |
| Amortization of discount and premium on assumed debt  | (267)                           | (171)            | 9               |
| Asset retirement obligation expense   | 104                             | 129              | 168             |
| Increase in other assets  | (265)                           | (399)            | (211)           |
| Increase in deferred rent liability   |                                 |                  | 2,510           |
| Increase in deferred rent receivable  | (3,230)                         | (3,700)          | (2,144)         |
| Increase (decrease) in accounts payable, accrued expenses, and amount due Adviser and Administrator | 204                             | (2,171)          | 2,746           |
| Increase in other liabilities   | 857                             | 1,437            | 743             |
| Leasing commissions paid  | (1,159)                         | (1,041)          | (1,738)         |
| <b>Net cash provided by operating activities</b>  | <b>28,197</b>                   | <b>19,885</b>    | <b>23,405</b>   |
| <b>Cash flows from investing activities:</b>  |                                 |                  |                 |
| Acquisition of real estate and related intangible assets  | (124,315)                       | (131,188)        | (82,239)        |
| Improvements of existing real estate  | (6,347)                         | (5,176)          | (5,557)         |
| Proceeds from sale of real estate   | 11,162                          |                  |                 |
| Issuance of mortgage note receivable  | (5,600)                         |                  |                 |
| Receipts from lenders for funds held in escrow  | 2,911                           | 5,545            | 1,959           |
| Payments to lenders for funds held in escrow  | (8,659)                         | (6,606)          | (5,463)         |
| Receipts from tenants for reserves  | 3,101                           | 6,085            | 2,870           |
| Payments to tenants from reserves   | (4,298)                         | (3,949)          | (2,543)         |
| Decrease (increase) in restricted cash  | 1,504                           | (2,117)          | (461)           |
| Deposits on future acquisitions   | (3,050)                         | (2,375)          | (550)           |
| Deposits applied against real estate investments  | 3,150                           | 2,725            |                 |
| <b>Net cash used in investing activities</b>  | <b>(130,441)</b>                | <b>(137,056)</b> | <b>(91,984)</b> |
| <b>Cash flows from financing activities:</b>  |                                 |                  |                 |

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|  |           |           |           |
|--|-----------|-----------|-----------|
| Proceeds from issuance of equity   | 73,931    | 88,121    | 4,191     |
| Offering costs   | (3,140)   | (4,963)   | (300)     |
| Proceeds from issuance of mandatorily redeemable preferred stock                 |           |           | 38,500    |
| Borrowings under mortgage notes payable  | 52,085    | 79,995    | 99,455    |
| Payments for deferred financing costs  | (1,029)   | (2,051)   | (4,598)   |
| Principal repayments on mortgage notes payable                                   | (8,144)   | (16,407)  | (52,285)  |
| Principal repayments on employee notes receivable                                |           | 35        | 12        |
| Borrowings from line of credit   | 98,450    | 75,400    | 41,800    |
| Repayments on line of credit   | (79,550)  | (76,000)  | (35,500)  |
| Increase (decrease) in security deposits   | 57        | (19)      | 134       |
| Distributions paid for common, senior common and preferred stock                 | (30,363)  | (23,940)  | (20,613)  |
| Net cash provided by financing activities  | 102,297   | 120,171   | 70,796    |
| Net increase in cash and cash equivalents  | 53        | 3,000     | 2,217     |
| Cash and cash equivalents, beginning of period                                   | 8,546     | 5,546     | 3,329     |
| Cash and cash equivalents, end of period   | \$ 8,599  | \$ 8,546  | \$ 5,546  |
| <b>NON-CASH INVESTING AND FINANCING INFORMATION</b>                              |           |           |           |
| Cash paid during year for interest   | \$ 27,557 | \$ 26,679 | \$ 21,239 |
| Increase in asset retirement obligation assumed in acquisition                   | \$ 405    | \$        | \$ 298    |
| Fixed rate principal debt assumed in connection with acquisition                 | \$ 10,146 | \$        | \$ 24,926 |
| Senior common dividend issued in the dividend reinvestment program               | \$ 211    | \$ 126    | \$ 26     |
| Capital improvements included in accounts payable and accrued expenses           | \$ 5,510  | \$ 350    | \$        |
| Fixed asset additions paid for by tenant   | \$ 2,031  | \$        | \$        |
| Property conveyed in deed in lieu for full satisfaction of mortgage note payable | \$ 17,373 | \$        | \$        |
| Security deposit applied to rental income  | \$ 147    | \$        | \$        |

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

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**Gladstone Commercial Corporation**

**Notes to Consolidated Financial Statements**

**1. Organization, Basis of Presentation and Significant Accounting Policies**

Gladstone Commercial Corporation 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, commercial and retail real property and selectively making long-term industrial and commercial mortgage loans. Subject to certain restrictions and limitations, our business is managed by Gladstone Management Corporation, a Delaware corporation, or the Adviser, and administrative services are provided by Gladstone Administration, LLC, a Delaware limited liability company, or the Administrator, each pursuant to a contractual arrangement with us. Our Adviser and Administrator collectively employ all of our personnel and pay their salaries, benefits, and general expenses directly.

All further references herein to we, our, us and the Company mean Gladstone Commercial Corporation and its consolidated subsidiaries, except where it is made clear that the term means only Gladstone Commercial Corporation. All references to the number of properties and square footage are unaudited.

*Subsidiaries*

We conduct substantially all of our operations through a subsidiary, Gladstone Commercial Limited Partnership, a Delaware limited partnership, or the Operating Partnership. As we currently own all of the general and limited partnership interests of the Operating Partnership through two of our subsidiaries, GCLP Business Trust I and II, the financial position and results of operations of the Operating Partnership are consolidated within our financial statements.

Gladstone Commercial Lending, LLC, a Delaware limited liability company, or Gladstone Commercial Lending, a subsidiary of ours, was created to conduct all operations related to our real estate mortgage loans. 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 ours.

Gladstone Commercial Advisers, Inc., a Delaware corporation, or Commercial Advisers, and a wholly-owned subsidiary of ours, is a taxable REIT subsidiary, or TRS, which was created to collect any non-qualifying income related to our real estate portfolio. There has been no such income earned to date. Since we own 100% of the voting securities of Commercial Advisers, the financial position and results of operations of Commercial Advisers are consolidated within our financial statements.

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

*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 periods. Actual results could materially differ from those estimates.

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**Table of Contents***Real Estate and Lease Intangibles*

We record investments in real estate at cost and capitalize improvements and replacements when they extend the useful life or improve the efficiency of the asset. We expense costs of repairs and maintenance as such costs are incurred. We compute depreciation using the straight-line method over the estimated useful life, or 39 years, for buildings and improvements, 5 to 20 years for equipment and fixtures, and the shorter of the useful life or the remaining lease term for tenant improvements and leasehold interests.

Certain of our acquisitions involve sale-leaseback transactions with newly-originated leases, which we account for as asset acquisitions under Accounting Standards Codification, or ASC, 805, Business Combinations. In the case of an asset acquisition, we will capitalize the transaction costs incurred in connection with the acquisition. Other of our acquisitions involve the acquisition of properties that are already being operated as rental properties, which we will generally consider to be a business combination under ASC 805. Business combination guidance is generally applicable to us when properties are acquired with leases in place at the time of acquisition. When an acquisition is considered a business combination, ASC 805 requires that the purchase price of real estate be allocated to the acquired tangible assets and liabilities, consisting of land, building, tenant improvements, long-term debt assumed and identified intangible assets and liabilities, typically the value of above-market and below-market leases, the value of in-place leases, the value of unamortized lease origination costs and the value of tenant relationships, based in each case on their fair values. ASC 805 also requires that all expenses related to an acquisition accounted for as a business combination to be expensed as incurred, rather than capitalized into the cost of the acquisition.

Management's estimates of fair 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 acquired and liabilities assumed. In estimating carrying costs, management also includes lost reimbursement of real estate taxes, insurance and other operating expenses as well as 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.

We allocate 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 on the date of acquisition. Real estate depreciation expense on these tangible assets was \$18.8 million, \$15.5 million, and \$11.9 million for the years ended December 31, 2014, 2013, and 2012, respectively

Above-market and below-market in-place lease fair 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. When determining the non-cancelable term of the lease, we evaluate which fixed-rate renewal options, if any, should be included. The capitalized above-market lease values, included in the accompanying condensed consolidated balance sheets 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 \$0.3 million, for each of the years ended December 31, 2014, 2013, and 2012, respectively. The capitalized

below-market lease values, included in the accompanying condensed consolidated balance sheets as part of deferred rent liability, are amortized as an increase to rental income over the remaining non-cancelable terms of the respective leases, including any below market renewal periods. Total amortization related to below-market lease values was \$0.7 million, \$0.6 million, and \$1.1 million for the years ended December 31, 2014, 2013, and 2012, respectively.

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The total amount of the remaining intangible assets acquired, which consists 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 our overall relationship with that respective tenant. Characteristics to be considered by management in determining 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 our expectations of lease renewals (including those existing under the terms of the lease agreement), among other factors.

The value of in-place leases and lease origination costs are amortized to amortization 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 us resulting from the likelihood of an existing tenant renewing its lease, are amortized to amortization 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. Total amortization expense related to these intangible assets and liabilities was \$10.0 million, \$7.3 million, and \$4.9 million for the years ended December 31, 2014, 2013, and 2012, respectively.

Should a tenant terminate its lease, the unamortized portion of the above-market and below-market lease values would be charged to rental income and the unamortized portion of in-place lease values, lease origination costs and customer relationship intangibles will be immediately charged to amortization expense.

### *Impairment Charges*

We account for the impairment of real estate, including intangible assets, in accordance with ASC 360-10-35, Property, Plant, and Equipment, which requires us to periodically review the carrying value of each property to determine if circumstances indicate impairment of the carrying value of the investment exists or that depreciation periods should be modified. If circumstances indicate 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 value of the investment in such property is recoverable. In performing the analysis, we consider such factors as each tenant's payment history and financial condition, the likelihood of lease renewal, business conditions in the industry in which the tenants operate, whether there are indications that the fair value of the real estate has decreased and our intended holding period of the property. If the carrying amount is more than the aggregate undiscounted future cash flows, we would recognize an impairment loss to the extent the carrying amount exceeds the estimated fair value of the property. We evaluate our entire portfolio of properties each quarter for any impairment indicators and perform an impairment analysis on those select properties that have an indication of impairment.

### *Cash and Cash Equivalents*

We consider cash equivalents to be 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. At times, the balance of our cash and cash equivalents may exceed federally insurable limits.

### *Restricted Cash*

Restricted cash consists of security deposits and receipts from tenants for reserves. 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 us of evidence of insurance and tax payments. For purposes of the

consolidated statements of cash flows, changes in restricted cash caused by changes in reserves held for tenants are shown as investing activities. Changes in restricted cash caused by changes in security deposits are reflected as financing activities.

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### *Funds Held in Escrow*

Funds held in escrow consist of funds held by certain of our lenders for properties held as collateral by these lenders. These funds will be released to us 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.

### *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. We made payments of \$1.0 million, \$2.1 million, and \$4.6 million for deferred financing costs during the years ended December 31, 2014, 2013, and 2012, respectively. Total amortization expense related to deferred financing costs is included in interest expense and was \$1.7 million, \$1.8 million, and \$1.5 million for the years ended December 31, 2014, 2013, and 2012, respectively.

### *Gains on Property Sales and Debt Extinguishment*

Gains on property sales and gains on debt extinguishment consist of the excess consideration or forgiveness of debt received for a property over the property carrying value at the time of sale or forgiveness. We recognize gains on property sales and gains on debt extinguishment in accordance with ASC 360-20, *Real Estate Sales*, or the date the debt is extinguished.

### *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 our leases contain rental increases at specified intervals. We recognize such revenues on a straight-line basis. 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 or in-place lease values of certain acquired properties. Accordingly, we determine, in our judgment, to what extent the deferred rent receivable applicable to each specific tenant is collectable. We review deferred rent receivable, as it relates to straight line rents, on a quarterly basis and take 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, we record an allowance for uncollectable accounts or record a direct write-off of the specific rent receivable. We have incurred \$0.8 million in deferred rent expense during the year ended December 31, 2014. No such reserves or direct write offs were recorded during the years ended December 31, 2013, and 2012, respectively.

Tenant recovery revenue includes payments from tenants as reimbursements for franchise taxes, management fees, insurance, maintenance and repairs, utilities, and ground lease payments. We recognize tenant recovery revenue in the same periods that we incur the related expenses.

### *Mortgage Note Receivable*

Management considers its loans and other lending investments to be held-for-investment. We reflect our loans classified as long-term investments at amortized cost, less allowance for loan losses, acquisition premiums or discounts, and deferred loan fees. On occasion, we may acquire loans at small premiums or discounts based on the

credit characteristics of such loans. These premiums or discounts would be

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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, we would immediately recognize 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.

*Income Taxes*

We have operated and intend to continue to operate in a manner that will allow us 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 we distribute at least 90% of our REIT taxable income to our stockholders and meet certain other conditions. To the extent that we satisfy the distribution requirement but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our 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, we would account for any future income taxes in accordance with the provisions of ASC 740, *Income Taxes*. Under ASC 740-10-25, we would account 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.

We may recognize a tax benefit from an uncertain tax position when it is more-likely-than-not (defined as a likelihood of more than 50%) that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. If a tax position does not meet the more-likely-than-not recognition threshold, despite our belief that the filing position is supportable, the benefit of that tax position is not recognized in the statements of operations. We recognize interest and penalties, as applicable, related to unrecognized tax benefits as a component of income tax expense. We recognize unrecognized tax benefits in the period that the uncertainty is eliminated by either affirmative agreement of the uncertain tax position by the applicable taxing authority, or by expiration of the applicable statute of limitation. For the years ended December 31, 2014, 2013 and 2012, we did not record any provisions for uncertain tax positions.

*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. We have accrued a liability at the present value of the estimated payments expected to be made 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. The liabilities are accreted to their estimated obligation over the life of the leases for the respective properties. We accrued \$0.4 million, \$0.0 million and \$0.3 million in liabilities in connection with acquisitions for the years ended December 31, 2014, 2013 and 2012, respectively. We recorded expense of \$0.1 million, \$0.1 million, and \$0.2 million during the years ended December 31, 2014, 2013 and 2012, respectively, to general and administrative expense. Costs of future expenditures for obligations are discounted to their present value.

The aggregate undiscounted obligation on all properties is \$9.4 million and the discount rates used in the calculations range from 2.5% to 7.6%. We do not expect to make any payments in conjunction with these obligations in each of the next five years.

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### *Stock Issuance Costs*

We account 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 may properly be deferred and charged against the gross proceeds of the offering. Accordingly, we record costs incurred related to our ongoing equity offerings to other assets on our consolidated balance sheet and ratably apply 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 allocated to the cost of the offering, the remaining amounts are recorded as a general and administrative expense on our consolidated statements of operations.

### *Comprehensive Income (Loss)*

For the years ended December 31, 2014, 2013, and 2012, comprehensive income (loss) equaled net income (loss); therefore, a separate statement of comprehensive income (loss) is not included in the accompanying consolidated financial statements.

### *Segment Reporting*

We manage our operations on an aggregated, single segment basis for purposes of assessing performance and making operating decisions, and, accordingly, have only one reporting and operating segment.

### *Recently Issued Accounting Pronouncements*

In August 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update 2014-15 ( ASU 2014-15), Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern. ASU 2014-15 requires management to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, and to provide certain disclosures when it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued. Since this guidance is primarily around certain disclosures to the financial statements, we anticipate no impact on our financial position, results of operations or cash flows from adopting this standard. We are currently assessing the additional disclosure requirements, if any, of ASU 2014-15. ASU 2014-15 is effective for the annual period ending after December 15, 2016 and for annual periods and interim periods thereafter, with early adoption permitted.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which supersedes or replaces nearly all GAAP revenue recognition guidance. The new guidance establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time and will expand disclosures about revenue. We are currently assessing the impact of ASU 2014-09. ASU 2014-09 is effective for annual reporting periods that begin after December 15, 2016 and interim periods within those years. Early adoption is not permitted.

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. Under this revised guidance, only disposals representing a strategic shift in operations, such as a disposal of a major geographic area, a major line of business or a major equity method investment, will be presented as discontinued operations. This standard is effective for our fiscal year beginning January 1, 2015; however, the FASB has permitted early adoption beginning with the first quarter of 2014. We adopted this standard during the quarter ended March 31, 2014, and accordingly we did not present our assets classified as held for sale during the quarter

ended March 31, 2014 as discontinued operations.

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**Table of Contents****2. Related-Party Transactions****Gladstone Management and Gladstone Administration**

We are externally managed pursuant to contractual arrangements with our Adviser and our Administrator which collectively employ all of our personnel and pay their salaries, benefits, and general expenses directly. Both our Adviser and Administrator are affiliates of ours as their parent company is controlled by Mr. David Gladstone, our chairman and chief executive officer. We have an advisory agreement with our Adviser, or the Advisory Agreement, and an administration agreement with our Administrator, or the Administration Agreement. The management and administrative services and fees under the Advisory and Administration Agreements are described below. At December 31, 2014 and 2013, \$0.9 million and \$1.4 million, respectively, was collectively due to our Adviser and Administrator.

*Advisory Agreement*

The Advisory Agreement provides for an annual base management fee equal to 2% of our total stockholders' equity, less the recorded value of any preferred stock and adjusted to exclude the effect of any unrealized gains, losses or other items that do not affect realized net income (including impairment charges), or common stockholders' equity, and an incentive fee based on funds from operations, or FFO. For the years ended December 31, 2014, 2013, and 2012, we recorded a base management fee of \$2.8 million, \$2.0 million, and \$1.5 million, respectively. The Adviser's Board of Directors voted to give us a credit to the base management fee for the year ended December 31, 2014 of \$0.2 million.

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 (including impairment charges). The incentive fee rewards the Adviser if our quarterly FFO, before giving effect to any incentive fee, or pre-incentive fee FFO, exceeds 1.75%, or 7% annualized, or the hurdle rate, of total common stockholders' equity. The Adviser receives 100% of the amount of the pre-incentive fee FFO that exceeds the hurdle rate, but is less than 2.1875% of our common stockholders' equity. The Adviser also receives an incentive fee of 20% of the amount of our pre-incentive fee FFO that exceeds 2.1875% of common stockholders' equity.

For the years ended December 31, 2014, 2013, and 2012, we recorded an incentive fee of \$4.3 million, \$4.2 million, and \$3.6 million, respectively, offset by credits related to unconditional, voluntary and irrevocable waivers issued by the Adviser of \$3.0 million, \$3.5 million, and \$2.2 million, respectively, resulting in a net incentive fee for the years ended December 31, 2014, 2013, and 2012, of \$1.3 million, \$0.7 million, and \$1.4 million, respectively. Our Board of Directors accepted the Adviser's offer to waive, on a quarterly basis, a portion of the incentive fee for the years ended December 31, 2014, 2013, and 2012, in order to support the current level of distributions to our stockholders. This waiver may not be recouped by the Adviser in the future.

*Administration Agreement*

Pursuant to the Administration Agreement, we pay for our allocable portion of the Administrator's expenses in performing services to us, including, but not limited to, rent and the salaries and benefits of its personnel, including our chief financial officer, treasurer, chief compliance officer, general counsel and secretary (who also serves as our Administrator's president), and their respective staffs. Prior to July 1, 2014, our allocable portion was generally derived by multiplying that portion of the Administrator's expenses allocable to all funds managed by the Adviser by the percentage of our total assets at the beginning of each quarter in comparison to the total assets of all funds

managed by the Adviser. As approved by our Board of Directors, effective July 1, 2014, our allocable portion of the Administrator's expenses will generally be derived by multiplying our Administrator's total expenses by the approximate percentage of time the Administrator's employees perform services for us in relation to their time spent performing services for all companies serviced by our Administrator under contractual agreements. For the years ended December 31, 2014, 2013, and 2012, we recorded an administration fee of \$1.5 million, \$1.5 million, and \$1.1 million, respectively.

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### Gladstone Securities

Gladstone Securities, LLC, or Gladstone Securities, is a privately held broker dealer registered with The Financial Industry Regulatory Authority and insured by the Securities Investor Protection Corporation. Gladstone Securities is an affiliate of ours, as its parent company is controlled by Mr. David Gladstone, our chairman and chief executive officer. Mr. Gladstone also serves on the board of managers of Gladstone Securities.

### *Dealer Manager Agreement*

In connection with the offering of our Senior Common Stock (see Note 10, Stockholders Equity, for further details) we entered into a Dealer Manager Agreement, dated March 25, 2011, or the Dealer Manager Agreement, with Gladstone Securities pursuant to which Gladstone Securities agreed to act as our exclusive dealer manager in connection with the offering. Pursuant to the terms of the Dealer Manager Agreement, Gladstone Securities is entitled to receive a sales commission in the amount of 7.0% of the gross proceeds of the shares of Senior Common Stock sold, plus a dealer manager fee in the amount of 3.0% of the gross proceeds of the shares of Senior Common Stock sold. Gladstone Securities, in its sole and absolute discretion, may re-allocate all of its selling commissions attributable to a participating broker-dealer and may also re-allocate a portion of its dealer manager fee earned in respect of the proceeds generated by the participating broker-dealer to any participating broker-dealer as a non-accountable marketing allowance. In addition, we have agreed to indemnify Gladstone Securities against various liabilities, including certain liabilities arising under the federal securities laws. We made approximately \$0.6 million, \$0.3 million, and \$0.2 million of payments during the years ended December 31, 2014, 2013, and 2012 respectively, to Gladstone Securities pursuant to this agreement, which are reflected as a component of Senior Common Stock costs in the consolidated statement of stockholders equity. The Dealer Manager Agreement currently is scheduled to terminate on the earlier of (i) March 28, 2015 or (ii) the date on which 3,000,000 shares of Senior Common Stock are sold pursuant to the Dealer Manager Agreement. We have elected not to renew the program upon termination on March 28, 2015 and thus the Dealer Manager Agreement will also simultaneously terminate on March 28, 2015.

### *Mortgage Financing Arrangement Agreement*

We also entered into an agreement with Gladstone Securities, effective June 18, 2013, for it to act as our non-exclusive agent to assist us with arranging mortgage financing for properties we own. In connection with this engagement, Gladstone Securities may from time to time solicit the interest of various commercial real estate lenders or recommend to us third party lenders offering credit products or packages that are responsive to our needs. We pay Gladstone Securities a financing fee in connection with the services it provides to us for securing mortgage financing on any of our properties. The amount of these financing fees, which are payable upon closing of the financing, are based on a percentage of the amount of the mortgage, generally ranging from 0.15% to a maximum of 1.0% of the mortgage obtained. The amount of the financing fees may be reduced or eliminated, as determined by us and Gladstone Securities, after taking into consideration various factors, including, but not limited to, the involvement of any third party brokers and market conditions. We paid financing fees to Gladstone Securities of \$0.1 million during both the years ended December 31, 2014, and 2013, respectively, which are reflected as deferred financing costs in the consolidated balance sheets, on total mortgages secured of \$52.1 million and \$76.3 million, or 0.27% and 0.18%, respectively. The agreement is scheduled to terminate on August 31, 2015, unless renewed or earlier terminated pursuant to the provisions contained therein.

**Table of Contents****3. Loss per Share of Common Stock**

The following tables set forth the computation of basic and diluted loss per share of common stock for the years ended December 31, 2014, 2013, and 2012. We computed basic loss per share for the years ended December 31, 2014, 2013 and 2012 using the weighted average number of shares outstanding during the periods. Diluted loss per share for the years ended December 31, 2014, 2013 and 2012, reflects additional shares of common stock related to our convertible Senior Common Stock (if the effect would be dilutive), 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 (dollars in thousands, except per share amounts).

|  | For the year ended December 31, |            |            |
|--|---------------------------------|------------|------------|
|  | 2014                            | 2013       | 2012       |
| <b>Calculation of basic loss per share of common stock:</b>                    |                                 |            |            |
| Net loss attributable to common stockholders                                   | \$ (10,538)                     | \$ (2,867) | \$ (445)   |
| Denominator for basic weighted average shares of common stock                  | 17,253,503                      | 13,164,244 | 10,953,325 |
| Basic loss per share of common stock   | \$ (0.61)                       | \$ (0.22)  | \$ (0.04)  |
| <b>Calculation of diluted loss per share of common stock:</b>                  |                                 |            |            |
| Net loss attributable to common stockholders                                   | \$ (10,538)                     | \$ (2,867) | \$ (445)   |
| Add: Income impact of assumed conversion of senior common stock <sup>(1)</sup> |                                 |            |            |
| Net loss attributable to common stockholders plus assumed conversions          | \$ (10,538)                     | \$ (2,867) | \$ (445)   |
| Denominator for basic weighted average shares of common stock                  | 17,253,503                      | 13,164,244 | 10,953,325 |
| Effect of convertible senior common stock <sup>(1)</sup>                       |                                 |            |            |
| Denominator for diluted weighted average shares of common stock                | 17,253,503                      | 13,164,244 | 10,953,325 |
| Diluted loss per share of common stock   | \$ (0.61)                       | \$ (0.22)  | \$ (0.04)  |

(1) We excluded convertible senior common shares of 428,509, 238,126, and 121,891 from the calculation of diluted earnings per share for the years ended December 31, 2014, 2013 and 2012, respectively, because it was anti-dilutive.

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

The following table sets forth the components of our investments in real estate as of December 31, 2014 and 2013 (dollars in thousands):

|                           | December 31, 2014 | December 31, 2013 |
|---------------------------|-------------------|-------------------|
| Real estate:              |                   |                   |
| Land                      | \$ 88,394         | \$ 79,153         |
| Building and improvements | 593,155           | 527,230           |
| Tenant improvements       | 41,016            | 35,970            |
| Accumulated depreciation  | (92,133)          | (81,241)          |
| Real estate, net          | \$ 630,432        | \$ 561,112        |

**Table of Contents***2014 Real Estate Activity*

During the year ended December 31, 2014, we completed 10 acquisitions of 11 properties and completed an expansion of one property, which are summarized below (dollars in thousands):

| Location           | Acquisition Date          | Square Footage (unaudited) | Lease Term                | Renewal Options                 | Total Purchase Price/Expansion Funded | Acquisition Expenses | Annualized Straight Line Rent | Debt Issued & Assumed |
|--------------------|---------------------------|----------------------------|---------------------------|---------------------------------|---------------------------------------|----------------------|-------------------------------|-----------------------|
| Allen, TX          | 3/27/2014                 | 21,154                     | 12 Years                  | 4 (5 years each)                | \$ 5,525                              | \$ 33                | \$ 570                        | \$ 3,481              |
| Colleyville, TX    | 3/27/2014                 | 20,355                     | 12 Years                  | 4 (5 years each)                | 4,523                                 | 33                   | 467                           | 2,849                 |
| Rancho Cordova, CA | <sup>(4)</sup> 4/22/2014  | 61,358                     | 10 Years                  | 1 (5 year)                      | 8,225                                 | 73                   | 902                           | 4,935                 |
| Coppell, TX        | 5/8/2014                  | 21,171                     | 12 Years                  | 4 (5 years each)                | 5,838                                 | 26                   | 601                           | 3,816                 |
| Columbus, OH       | 5/13/2014                 | 114,786                    | 9.5 Years <sup>(1)</sup>  | N/A <sup>(1)</sup>              | 11,800                                | 70                   | 1,278 <sup>(3)</sup>          | N/A                   |
| Taylor, PA         | 6/9/2014                  | 955,935                    | 10 Years                  | 4 (5 years each)                | 39,000                                | 730                  | 3,400                         | 22,600                |
| Aurora, CO         | 7/1/2014                  | 124,800                    | 15 Years                  | 2 (5 years each)                | 8,300                                 | 93                   | 768                           | N/A                   |
| Indianapolis, IN   | <sup>(4)</sup> 9/3/2014   | 86,495                     | 11.5 Years <sup>(2)</sup> | 2 (5 years each) <sup>(2)</sup> | 10,500                                | 63                   | 1,504 <sup>(3)</sup>          | 6,100                 |
| Denver, CO         | 10/31/2014                | 189,120                    | 10 Years                  | 2 (10 years each)               | 10,000                                | 103                  | 860                           | N/A                   |
| Canton, NC         | <sup>(5)</sup> 11/1/2014  | 365,960                    | 20 Years                  | 2 (10 years each)               | 5,550                                 | N/A                  | 1,343                         | N/A                   |
| Monroe, MI         | <sup>(6)</sup> 12/23/2014 | 535,500                    | 8.5 Years                 | 2 (5 years each)                | 30,750                                | 68                   | 2,523                         | 18,450                |
| <b>Total</b>       |                           | <b>2,496,634</b>           |                           |                                 | <b>\$ 140,011</b>                     | <b>\$ 1,292</b>      | <b>\$ 14,216</b>              | <b>\$ 62,231</b>      |

(1) Lease term and renewal options are reflective of the largest tenant. The smaller tenant's lease terminates in November 2016 and contains no renewal options.

(2) Lease term and renewal options are reflective of the largest tenant. The other tenants in the building have varying lease expirations from December 2015 to October 2018. No other tenants have renewal options.

(3) Rent figure is reflective of aggregate rent among all tenants occupying the building.

(4) Tenants occupying these properties are subject to a gross lease. The largest tenant in this property occupies 61,306 square feet.

(5) The Canton, NC property was originally acquired in July 2004 for \$5.2 million. After the expansion was completed in November 2014, our total investment in the property is \$10.8 million.

(6) This property acquisition consists of two buildings with two separate leases which have identical lease terms. The figures above are aggregated to reflect both buildings.

In accordance with ASC 805, we determined the fair value of the acquired assets and assumed liabilities related to the 11 properties acquired during the year ended December 31, 2014 as follows (dollars in thousands):

|      |          |               |
|------|----------|---------------|
| Land | Building | Leasing Costs |
|------|----------|---------------|

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|                       |           | Tenant       | In-place | Custom        | Above    | Below    | Market  | Premium    | Total    | Purchase   |
|-----------------------|-----------|--------------|----------|---------------|----------|----------|---------|------------|----------|------------|
|                       |           | Improvements | Leases   | Relationships | Leases   | Leases   | Assumed | Debt       |          | Price      |
| Allen, TX             | \$ 874    | \$ 3,509     | \$ 125   | \$ 598        | \$ 273   | \$ 218   | \$      | \$         | \$ (72)  | \$ 5,525   |
| Colleyville,<br>TX    | 1,277     | 2,307        | 117      | 486           | 220      | 181      |         | (6)        | (59)     | 4,523      |
| Rancho<br>Cordova, CA | 752       | 5,898        | 278      | 473           | 546      | 278      |         |            |          | 8,225      |
| Coppell, TX           | 1,448     | 3,221        | 128      | 636           | 293      | 230      |         |            | (118)    | 5,838      |
| Columbus,<br>OH       | 990       | 6,080        | 1,937    | 823           | 719      | 990      | 261     |            |          | 11,800     |
| Taylor, PA            | 3,102     | 24,449       | 956      | 6,171         | 1,452    | 2,870    |         |            |          | 39,000     |
| Aurora, CO            | 2,882     | 3,825        | 92       | 413           | 806      | 282      |         |            |          | 8,300      |
| Indianapolis,<br>IN   | 502       | 5,334        | 1,088    | 1,990         | 741      | 732      | 126     | (13)       |          | 10,500     |
| Denver, CO            | 1,621     | 6,503        | 568      | 1,152         | 721      | 652      |         | (1,217)    |          | 10,000     |
| Monroe, MI (1)        | 1,118     | 23,890       | 942      | 1,497         | 1,350    | 1,953    |         |            |          | 30,750     |
|                       | \$ 14,566 | \$ 85,016    | \$ 6,231 | \$ 14,239     | \$ 7,121 | \$ 8,386 | \$ 387  | \$ (1,236) | \$ (249) | \$ 134,461 |

(1) This property acquisition consists of two buildings with two separate leases which have identical lease terms. The figures above are aggregated to reflect both buildings.

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Below is a summary of the total revenue and earnings recognized on the 11 properties acquired during the year ended December 31, 2014 (dollars in thousands):

| Location           | Acquisition<br>Date       | For the year ended December 31,<br>2014 |                         |
|--------------------|---------------------------|---|-------------------------|
|                    |                           | Rental Revenue                          | Earnings <sup>(1)</sup> |
| Allen, TX          | 3/27/2014                 | \$ 435                                  | \$ 249                  |
| Colleyville, TX    | 3/27/2014                 | 357                                     | 206                     |
| Rancho Cordova, CA | 4/22/2014                 | 625                                     | 239                     |
| Coppell, TX        | 5/8/2014                  | 390                                     | 226                     |
| Columbus, OH       | <sup>(2)</sup> 5/13/2014  | 790                                     | 272                     |
| Taylor, PA         | 6/9/2014                  | 1,908                                   | 890                     |
| Aurora, CO         | 7/1/2014                  | 384                                     | 253                     |
| Indianapolis, IN   | <sup>(2)</sup> 9/3/2014   | 489                                     | 44                      |
| Denver, CO         | 10/31/2014                | 166                                     | 82                      |
| Monroe, MI         | <sup>(3)</sup> 12/23/2014 | 61                                      | 31                      |
|                    |                           | \$ 5,605                                | \$ 2,492                |

- (1) Earnings is calculated as net income exclusive of both interest expense and acquisition related costs that are required to be expensed under ASC 805.
- (2) Rental revenue and earnings is reflective of aggregate rent and operating expenses among all tenants occupying the building.
- (3) We acquired two properties and two leases with this acquisition. Rental revenue and earnings is reflective of aggregate rent and operating expenses among both properties.

*Pro Forma*

The following table reflects pro-forma consolidated statements of operations as if the properties acquired during the years ended December 31, 2014 and 2013, respectively were acquired as of January 1, 2013. The table also assumes that properties acquired during the years ended December 31, 2013 and 2012, respectively, were acquired as of January 1, 2012. The pro-forma earnings for the years ended December 31, 2014, 2013 and 2012 were adjusted to assume that acquisition-related costs were incurred as of the beginning of the earliest period presented (dollars in thousands, except per share amounts):

|                          | For the year ended December 31, (unaudited) |           |           |
|--------------------------|---|-----------|-----------|
|                          | 2014  | 2013      | 2012      |
| <b>Operating Data:</b>   |   |           |           |
| Total operating revenue  | \$ 80,759                                   | \$ 80,081 | \$ 68,940 |
| Total operating expenses | (60,728)                                    | (46,223)  | (37,457)  |
| Other expenses           | (24,290)                                    | (32,929)  | (28,754)  |
| Net income (loss)        | (4,259) <sup>(1)</sup>                      | 929       | 2,729     |
|                          | (4,636)                                     | (4,394)   | (4,206)   |

Dividends attributable to preferred and senior common stock

|  |            |            |            |
|--|------------|------------|------------|
| Net loss attributable to common stockholders | \$ (8,895) | \$ (3,465) | \$ (1,477) |
|--|------------|------------|------------|

**Share and Per Share Data:**

|   |            |            |            |
|---|------------|------------|------------|
| Basic and diluted loss per share of common stock      | \$ (0.52)  | \$ (0.26)  | \$ (0.13)  |
| Weighted average shares outstanding-basic and diluted | 17,253,503 | 13,164,244 | 10,953,325 |

- (1) We recognized a \$14.2 million impairment loss and a \$5.3 million gain on debt extinguishment as a result of our Roseville, MN deed in lieu transaction during the year ended December 31, 2014.

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### *Significant Real Estate Activity on Existing Assets*

On April 4, 2014, our tenant occupying our Newburyport, Massachusetts property notified us of their intention not to exercise their renewal option, as the tenant is relocating to Rhode Island. The tenant will continue paying rent and operating expenses through the lease termination date of April 30, 2015.

On May 6, 2014, we extended the lease with the tenant occupying our property located in Austin, Texas. The lease covering this property was extended for an additional eight years, through June 2022. The lease was originally set to expire in June 2015. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$0.7 million. In connection with the extension of the lease and modification of certain terms of the lease, we paid \$0.2 million in leasing commissions, and will pay a total of approximately \$1.3 million in tenant improvements prior to the end of second quarter 2015.

On June 11, 2014, we extended the lease with the tenant occupying our property located in Burnsville, Minnesota. The new lease covers approximately two-thirds of the space and was extended for an additional eight years, through January 2023. The lease was originally set to expire in June 2015. The tenant in this property will continue to pay rent on the entire building through June 2015, and we are working to identify tenants to lease the remaining one-third of the building. The new lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$1.0 million. Rental income per square foot increased 14% from the previous lease. The lease grants the tenant two options to extend the lease for an additional three years each. In connection with the extension of the lease and the modification of certain terms under the lease, we paid \$0.5 million in leasing commissions, and will pay \$3.3 million in tenant improvements prior to the end of first quarter 2015.

On July 7, 2014, we extended the lease with one of the tenants occupying our property located in Akron, Ohio. The new lease covers approximately two-thirds of the space and was extended for an additional five years, through March 2020. The lease was originally set to expire in March 2015. This tenant will continue to pay its existing rent through March 2015. The new lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$0.6 million. The lease grants the tenant two options to extend the lease for an additional five years each. In connection with the extension of the lease and the modification of certain terms under the lease, we paid \$0.2 million in leasing commissions, and will pay \$0.9 million in tenant improvements prior to the end of second quarter 2015. On December 24, 2014, we extended the lease with the other tenant occupying our property located in Akron, Ohio. The new lease covers the remaining space and was extended for an additional five years through March 2020. The lease was originally set to expire in March 2015. This tenant will also continue to pay its existing rent through March 2015. The new lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of \$0.1 million. The lease grants the tenant two options to extend the lease for an additional five years each. In connection with the extension of the lease and the modification of certain terms under the lease, we will pay \$0.1 million in tenant improvements during fiscal year 2015.

On September 25, 2014, we modified the lease with the tenant occupying our property located in Concord Township, Ohio. The lease covering this property was adjusted to defer a portion of rental payments covering the period August 2014 through December 2014. The tenant will repay the deferred rent balance monthly during calendar year 2015. On November 14, 2014, we further modified the lease with this tenant. The lease covering this property was adjusted to change the lease termination date from August 2034, to December 2024. Accordingly, annual straight line rent decreased from \$1.7 million under the prior amendment, to \$1.4 million. The lease grants the tenant three options to extend the lease for an additional five years each. Upon execution of this lease amendment, we determined that a portion of our existing deferred rent balance of \$2.5 million was uncollectible, due to the reduction in lease payments and lease term, and we adjusted the balance by approximately \$0.8 million, which is recorded in general and administrative expense.

On October 16, 2014, we executed a lease with a tenant to occupy our previously vacant property located in Richmond, Virginia. The lease was effective as of September 8, 2014 and has a three-year term. The tenant

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has an early termination option at any time after July 31, 2016, contingent upon the tenant losing a contract with the vendor supporting their operations in our building. The tenant is subject to a termination payment of approximately \$0.03 million if they exercise this option. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$0.2 million. The tenant has one option to renew the lease for an additional period of three years. In connection with the extension of the lease and modification of certain terms of the lease, we paid \$0.1 million in leasing commissions. No tenant improvements were paid in connection with the new lease.

On October 22, 2014, we extended the lease with the tenant occupying our property located in Canton, North Carolina. We financed a \$5.5 million expansion project on this property, which added an additional 150,000 square feet to the building, which was completed in November 2014. The lease covering this property was extended for an additional 10 years, through September 2034. The lease was originally set to expire in July 2024. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$1.4 million, as compared to straight line rents of \$0.6 million under the previous lease.

On October 27, 2014, we extended the lease with the tenant occupying our property located in South Hadley, Massachusetts. The lease covering this property was extended for an additional two years through January 2017. The lease was originally set to expire in January 2015. The lease provides a scheduled rent increase over the previous lease, with annualized straight line rents of approximately \$0.3 million. The tenant has two options to renew the lease for additional periods of one year each.

On October 30, 2014, we modified the lease with the tenant occupying our property located in Tewksbury, Massachusetts. The lease covering this property was amended to reduce rental charges through the remaining lease term, which is set to expire May 31, 2017. In the event we identify a tenant or a purchaser for the property, we can terminate the lease with the current tenant. Straight line rent on this lease has decreased from \$0.9 million per year to \$0.4 million per year after the amendment.

On December 1, 2014, we executed a lease with a tenant to occupy a 7,125 square foot vacant outbuilding located on our property in Maple Heights, Ohio. The lease was effective as of December 1, 2014 and has a three-year term. The lease provides for consistent rental payments of \$0.03 million annually. In connection with the extension of the lease and modification of certain terms of the lease, we paid \$0.01 million in leasing commissions.

On December 1, 2014, we executed a lease with a tenant to occupy a portion of our property located in Bolingbrook, Illinois. The lease is for seven years and the tenant occupies 38% of the building. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$0.2 million. The tenant has one option to renew the lease for an additional period of five years. In connection with the extension of the lease and modification of certain terms of the lease, we paid \$0.2 million in leasing commissions, and will pay to \$0.5 million in tenant improvements during fiscal year 2015.

**Table of Contents***2013 Real Estate Activity*

During the year ended December 31, 2013, we acquired seven properties, and completed an expansion of one property, which are summarized below (dollars in thousands):

| Location                        | Acquisition/<br>Expansion Date | Square Footage<br>(unaudited) | Lease<br>Term | Renewal<br>Options | Total Purchase<br>Expansion Price | Acquisition<br>Expenses | Annualized Straight<br>Line<br>Rent | Debt Issued      |
|---------------------------------|--------------------------------|-------------------------------|---------------|--------------------|-----------------------------------|-------------------------|-------------------------------------|------------------|
| Egg Harbor Township, NJ         | 3/28/2013                      | 29,257                        | 10 years      | 1 (5 years)        | \$ 5,650                          | \$ 152                  | \$ 490                              | \$ 3,700         |
| Clintonville, WI <sup>(1)</sup> | 4/11/2013                      | 102,400                       | 15 years      | N/A                | 3,250                             | N/A                     | 961                                 |                  |
| Vance, AL                       | 5/9/2013                       | 170,000                       | 10 years      | 2 (5 years)        | 13,388                            | 186                     | 1,173                               |                  |
| Blaine, MN                      | 5/10/2013                      | 92,275                        | 7 years       | 2 (5 years)        | 14,450                            | 79                      | 1,475                               | 8,200            |
| Austin, TX                      | 7/9/2013                       | 320,000                       | 7 years       | 3 (3 years)        | 57,000                            | 155                     | 4,641                               | 35,300           |
| Allen, TX                       | 7/10/2013                      | 115,200                       | 9 years       | 2 (5 years)        | 15,150                            | 81                      | 1,478                               | 8,900            |
| Englewood, CO                   | 12/11/2013                     | 99,797                        | 8 years       | 2 (5 years)        | 18,250                            | 66                      | 1,497                               | 11,315           |
| Novi, MI                        | 12/27/2013                     | 156,200                       | 10 years      | 1 (5 years)        | 7,300                             | 42                      | 684                                 | 4,380            |
| <b>Total</b>                    |                                | <b>1,085,129</b>              |               |                    | <b>\$ 134,438</b>                 | <b>\$ 761</b>           | <b>\$ 12,399</b>                    | <b>\$ 71,795</b> |

<sup>(1)</sup> The Clintonville, WI property was originally acquired in November 2005 for \$5.3 million. After the expansion was completed in April 2013, the total investment in the property is \$8.6 million.

In accordance with ASC 805, we determined the fair value of acquired assets related to the seven properties acquired during the year ended December 31, 2013 as follows (dollars in thousands):

|                         | Land      | Building  | Tenant<br>Improvements | In-place<br>Leases | Leasing<br>Costs | Customer<br>Relationships | Above Market<br>Leases | Below Market<br>Leases | Total Purchase<br>Price |
|-------------------------|-----------|-----------|------------------------|--------------------|------------------|---------------------------|------------------------|------------------------|-------------------------|
| Egg Harbor Township, NJ | \$ 1,627  | \$ 2,735  | \$ 282                 | \$ 558             | \$ 189           | \$ 259                    | \$                     | \$                     | \$ 5,650                |
| Vance, AL               | 457       | 9,721     | 808                    | 1,097              | 678              | 627                       |                        |                        | 13,388                  |
| Blaine, MN              | 1,060     | 9,347     | 1,172                  | 1,361              | 694              | 816                       |                        |                        | 14,450                  |
| Austin, TX              | 2,330     | 37,207    | 6,814                  | 6,118              | 1,906            | 3,793                     | (1,168)                |                        | 57,000                  |
| Allen, TX               | 2,699     | 5,758     | 2,187                  | 1,525              | 1,146            | 1,499                     | 336                    |                        | 15,150                  |
| Englewood, CO           | 1,503     | 9,889     | 1,850                  | 2,036              | 1,178            | 1,850                     | (56)                   |                        | 18,250                  |
| Novi, MI                | 352       | 5,354     | 272                    | 663                | 434              | 225                       |                        |                        | 7,300                   |
|                         | \$ 10,028 | \$ 80,011 | \$ 13,385              | \$ 13,358          | \$ 6,225         | \$ 9,069                  | \$ 336                 | \$ (1,224)             | \$ 131,188              |

Below is a summary of the total revenue and earnings recognized on the seven properties acquired during the year ended December 31, 2013 (dollars in thousands):

For the year ended December 31,  
2013

| Location                | Acquisition<br>Date | Rental Revenue | Earnings <sup>(1)</sup> |
|-------------------------|---------------------|----------------|-------------------------|
| Egg Harbor Township, NJ | 3/28/2013           | \$ 373         | \$ 209                  |
| Vance, AL               | 5/9/2013            | 757            | 363                     |
| Blaine, MN              | 5/10/2013           | 947            | 424                     |
| Austin, TX              | 7/9/2013            | 2,299          | 655                     |
| Allen, TX               | 7/10/2013           | 685            | 300                     |
| Englewood, CO           | 12/11/2013          | 85             | 25                      |
| Novi, MI                | 12/27/2013          | 9              | 5                       |
|                         |                     | \$ 5,155       | \$ 1,981                |

- <sup>(1)</sup> Earnings is calculated as net income exclusive of both interest expense and acquisition related costs that are required to be expensed under ASC 805.

**Table of Contents***Future Lease Payments*

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 (dollars in thousands):

| Year       | Tenant<br>Lease Payments |
|------------|--------------------------|
| 2015       | \$ 70,794                |
| 2016       | 68,669                   |
| 2017       | 68,290                   |
| 2018       | 67,983                   |
| 2019       | 68,405                   |
| Thereafter | 312,030                  |

In accordance with the lease terms, substantially all operating expenses are required to be paid by the tenant; however, we would be required to pay property taxes on the respective properties in the event the tenants fail to pay them. The total annual property taxes for all properties owned by us as of December 31, 2014, were \$12.6 million.

*Intangible Assets*

The following table summarizes the carrying value of intangible assets and the accumulated amortization for each intangible asset class (in thousands):

|                        | December 31, 2014                     |                             | December 31, 2013 |                             |
|------------------------|---------------------------------------|-----------------------------|-------------------|-----------------------------|
|                        | Lease<br>Intangibles                  | Accumulated<br>Amortization | Lease Intangibles | Accumulated<br>Amortization |
| In-place leases        | \$ 59,233                             | \$ (17,379)                 | \$ 47,442         | \$ (15,158)                 |
| Leasing costs          | 38,305                                | (11,411)                    | 31,339            | (9,323)                     |
| Customer relationships | 41,243                                | (11,177)                    | 35,739            | (10,407)                    |
|                        | \$ 138,781                            | \$ (39,967)                 | \$ 114,520        | \$ (34,888)                 |
|                        | Deferred Rent<br>Receivable/Liability | Accumulated<br>Amortization | Lease Intangibles | Accumulated<br>Amortization |
| Above market leases    | \$ 8,314                              | \$ (6,384)                  | \$ 7,928          | \$ (6,085)                  |
| Below market leases    | \$ 15,939                             | \$ (7,345)                  | \$ 12,672         | \$ (6,657)                  |
|                        | \$ 24,253                             | \$ (13,729)                 | \$ 20,600         | \$ (12,742)                 |
| Total                  | \$ 163,034                            | \$ (53,696)                 | \$ 135,120        | \$ (47,630)                 |

The weighted average amortization periods in years for the intangible assets acquired and liabilities assumed during the years ended December 31, 2014 and 2013, respectively, were as follows:

| Intangible Assets & Liabilities     | 2014 | 2013 |
|-------------------------------------|------|------|
| In-place leases                     | 10.1 | 8.9  |
| Leasing costs                       | 10.1 | 8.9  |
| Customer relationships              | 15.1 | 13.7 |
| Above market leases                 | 9.3  | 8.8  |
| Below market leases                 | 10.0 | 7.5  |
| All intangible assets & liabilities | 11.5 | 10.0 |

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The estimated aggregate amortization expense to be recorded for in-place leases, leasing costs and customer relationships for each of the five succeeding fiscal years and thereafter is as follows (dollars in thousands):

| Year         | Estimated<br>Amortization Expense |
|--------------|-----------------------------------|
| 2015         | \$ 12,801                         |
| 2016         | 11,972                            |
| 2017         | 11,733                            |
| 2018         | 11,633                            |
| 2019         | 11,610                            |
| Thereafter   | 39,065                            |
| <b>Total</b> | <b>\$ 98,814</b>                  |

The estimated aggregate rental income to be recorded for the amortization of both above and below market leases for each of the five succeeding fiscal years and thereafter is as follows (dollars in thousands):

| Year         | Estimated Rental<br>Income |
|--------------|----------------------------|
| 2015         | \$ 557                     |
| 2016         | 438                        |
| 2017         | 432                        |
| 2018         | 432                        |
| 2019         | 432                        |
| Thereafter   | 4,374                      |
| <b>Total</b> | <b>\$ 6,665</b>            |

**5. Real Estate Dispositions and Impairment Charges***Real Estate Dispositions*

On June 6, 2014, we sold our property located in Sterling Heights, Michigan to the tenant currently occupying the building for \$11.4 million and incurred approximately \$0.2 million in selling costs. We recognized a gain of \$1.2 million on the sale.

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The table below summarizes the components of income from real estate and related assets disposed of for the Sterling Heights, Michigan property during the years ended December 31, 2014, 2013 and 2012, respectively (dollars in thousands):

|   | For the year ended December 31, |          |          |
|---|---------------------------------|----------|----------|
|   | 2014                            | 2013     | 2012     |
| Operating revenue                               | \$ 507                          | \$ 1,167 | \$ 1,167 |
| Operating expense                               | 46                              | 228      | 221      |
| Income from real estate and related assets sold | \$ 461                          | \$ 939   | \$ 946   |

*Impairment Charges*

We performed the evaluation and analysis of our portfolio and concluded that our Roseville, Minnesota property was impaired as of March 31, 2014. We determined that the expected undiscounted cash flows based upon a revised estimated holding period of this property was below the current carrying value. The estimated holding period was revised after a potential tenant that we were anticipating to lease a large portion of the vacant space, during the three months ended March 31, 2014, did not execute a lease on the property. Consequently, we revised the holding period to coincide with the maturity of the mortgage loan in June 2014. Accordingly, we reduced the carrying value of this property to its estimated fair value, less cost to sell, and we recognized an impairment loss of \$14.2 million during the year ended December 31, 2014. This property was returned to the lender in a deed in lieu transaction on November 12, 2014 (see Note 7).

We performed an analysis of both the real estate disposition and impaired property for the year ended December 31, 2014 and determined that these properties should not be classified as discontinued operations as neither constituted a strategic shift in our operations in accordance with ASU 2014-08.

We had previously reported that our property located in South Hadley, Massachusetts was at risk of becoming impaired in the future. We recently extended the lease on this property for two years, and it will now expire in January 2017. As a result of this lease extension, we no longer view this property as at risk for impairment.

We continue to monitor our portfolio for any other indicators of impairment.

**6. Mortgage Note Receivable**

On July 25, 2014, we closed a \$5.6 million second mortgage development loan for the construction of an 81,371 square foot, build-to-suit transitional care facility located on a major hospital campus in Phoenix, Arizona. Construction is scheduled to be completed in July 2015 and we will earn 9.0% interest, paid currently in cash, on the loan during construction and through maturity. Prior to completion of the facility, we will be granted a right of first offer to purchase the property at fair value. If we do not purchase the property we will receive an exit fee upon maturity of the loan in an amount sufficient for us to earn an internal rate of return of 22% on the second mortgage development loan, inclusive of interest earned. The loan is scheduled to mature in July 2016, but has a one-year extension option. We have recognized \$0.5 million in both cash interest income and accrued exit fee revenue during the year ended December 31, 2014.



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

Our mortgage notes payable and line of credit as of December 31, 2014 and December 31, 2013 are summarized below (dollars in thousands):

| Date of Issuance/<br>Assumption | Principal Maturity Date | Stated Interest Rate at December 31, 2014 <sup>(1)</sup> | Principal Balance Outstanding |                   |
|---------------------------------|-------------------------|--|-------------------------------|-------------------|
|                                 |                         |  | December 31, 2014             | December 31, 2013 |
| 02/21/06                        | 06/30/14                | 5.20%  |                               | 17,455            |
| 08/25/05                        | 09/01/15                | 5.33%  | 19,262                        | 19,664            |
| 09/12/05                        | 09/01/15                | 5.21%  | 11,369                        | 11,593            |
| 09/06/07                        | 12/11/15                | 5.81%  | 3,964                         | 4,052             |
| 12/21/05                        | 01/08/16                | 5.71%  | 17,482                        | 17,816            |
| 03/27/14                        | 02/01/16                | 5.58%  | 6,214                         |                   |
| 03/29/06                        | 04/01/16                | 5.92%  | 16,201                        | 16,434            |
| 04/27/06                        | 05/05/16                | 6.58%  | 12,316                        | 12,696            |
| 08/29/08                        | 06/01/16                | 6.80%  | 5,510                         | 5,687             |
| 05/08/14                        | 06/01/16                | 6.25%  | 3,767                         |                   |
| 06/20/11                        | 06/30/16                | 6.08%  | 10,977                        | 11,164            |
| 11/22/06                        | 12/01/16                | 5.76%  | 13,093                        | 13,324            |
| 11/26/13                        | 12/01/16                | LIBOR +2.15% <sup>(2)</sup>                              | 8,200                         | 8,200             |
| 12/22/06                        | 01/01/17                | 5.79%  | 20,026                        | 20,376            |
| 02/08/07                        | 03/01/17                | 6.00%  | 13,775                        | 13,775            |
| 06/05/07                        | 06/08/17                | 6.11%  | 13,825                        | 13,999            |
| 10/15/07                        | 11/08/17                | 6.63%  | 14,609                        | 14,848            |
| 09/26/12                        | 07/01/18                | 5.75%  | 10,252                        | 10,478            |
| 11/18/11                        | 11/01/18                | 4.50%  | 4,049                         | 4,155             |
| 06/09/14                        | 07/01/19                | 4.23%  | 22,600                        |                   |
| 12/06/11                        | 12/06/19                | 6.00%  | 7,776                         | 8,031             |
| 10/28/11                        | 11/01/21                | 6.00%  | 6,799                         | 6,938             |
| 04/05/12                        | 05/01/22                | 6.10%  | 18,116                        | 18,467            |
| 06/21/12                        | 07/06/22                | 5.05%  | 4,507                         | 4,608             |
| 08/03/12                        | 07/31/22                | 5.00%  | 2,845                         | 2,911             |
| 07/24/12                        | 08/01/22                | 5.60%  | 9,066                         | 9,361             |
| 10/01/12                        | 10/01/22                | 4.86%  | 32,397                        | 33,133            |
| 11/21/12                        | 12/06/22                | 4.04%  | 18,067                        | 18,525            |
| 03/28/13                        | 04/06/23                | 4.16%  | 3,551                         | 3,638             |
| 07/03/13                        | 08/01/23                | 5.00%  | 8,045                         | 8,163             |
| 07/10/13                        | 08/01/23                | 4.20%  | 8,704                         | 8,852             |
| 07/09/13                        | 08/06/23                | 4.81%  | 34,567                        | 35,093            |
| 12/27/13                        | 01/01/24                | 5.28%  | 4,297                         | 4,380             |
| 04/22/14                        | 05/01/24                | 4.90%  | 4,935                         |                   |
| 09/03/14                        | 10/01/24                | 4.40%  | 6,100                         |                   |
| 12/23/14                        | 01/01/25                | 4.04%  | 18,426                        |                   |

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|   |          |              |            |            |
|---|----------|--------------|------------|------------|
| 12/15/10  | 12/10/26 | 6.63%        | 9,015      | 9,496      |
| 05/16/12  | 12/31/26 | 4.30%        | 2,757      | 2,829      |
| 11/08/12  | 02/01/27 | 5.69%        | 13,567     | 13,864     |
| 05/30/12  | 05/10/27 | 6.50%        | 4,426      | 4,653      |
| 06/27/12  | 07/01/29 | 5.10%        | 1,823      | 1,905      |
| 12/18/13  | 01/06/39 | 4.74%        | 11,315     | 11,315     |
| Contractual Mortgage Notes Payable:             |          |              | \$ 458,592 | \$ 421,878 |
| Premiums and (Discounts), net:                  |          |              | 707        | 724        |
| Total Mortgage Notes Payable:                   |          |              | \$ 459,299 | \$ 422,602 |
| Variable-Rate Line of Credit:                   |          |              |            |            |
| 08/07/13  | 08/07/17 | LIBOR +3.00% | \$ 43,300  | \$ 24,400  |
| Total Mortgage Notes Payable and Line of Credit |          |              | \$ 502,599 | \$ 447,002 |

- (1) The weighted average interest rate on all debt outstanding at December 31, 2014, was approximately 5.11%.
- (2) At December 31, 2014, one month LIBOR was approximately 0.17%.

**Table of Contents***Mortgage Notes Payable*

As of December 31, 2014, we had 41 mortgage notes payable, collateralized by a total of 77 properties and the net book value of these collateralized properties was \$642.5 million. Gladstone Commercial Corporation has limited recourse liabilities that could result from any one or more of the following circumstances: 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, or physical waste or damage to the property resulting from a borrower's gross negligence or willful misconduct. We 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, 2014 was 5.3%.

During the year ended December 31, 2014, we assumed two long-term mortgages, collateralized by three properties, and issued four long-term mortgages, collateralized by five properties, which are summarized below (dollars in thousands):

| Date of Issuance | Issuing Bank        | Debt Issued | Interest Rate | Maturity Date |
|------------------|---------------------|-------------|---------------|---------------|
| 3/27/2014        | Wells Fargo N.A.    | \$ 6,330    | 5.58%         | 2/1/2016      |
| 4/22/2014        | Keybank N.A.        | 4,935       | 4.90%         | 5/1/2024      |
| 5/8/2014         | Wells Fargo N.A.    | 3,816       | 6.25%         | 6/1/2016      |
| 6/9/2014         | Prudential Mortgage |             |               |               |
|                  | Capital Company     | 22,600      | 4.23%         | 7/1/2019      |
| 9/3/2014         | Everbank            | 6,100       | 4.40%         | 10/1/2024     |
| 12/23/2014       | Prudential Mortgage |             |               |               |
|                  | Capital Company     | 18,450      | 4.04%         | 1/1/2025      |
|                  |                     | \$ 62,231   |               |               |

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

| Year       | Scheduled Principal Payments |
|------------|------------------------------|
| 2015       | \$ 42,436 <sup>(1)</sup>     |
| 2016       | 99,042                       |
| 2017       | 67,653                       |
| 2018       | 20,260                       |
| 2019       | 34,936                       |
| Thereafter | 194,265                      |
|            | \$ 458,592                   |

- (1) We are planning to refinance the 3 balloon principal payments that mature in the second half of 2015 with a combination of new mortgage debt or equity.

On November 12, 2014, we completed a deed-in-lieu transaction on our Roseville, Minnesota property, where we returned the property to the lender in exchange for cancellation of obligations under our debt agreement with the lender. At the time of the deed-in-lieu transaction, the carrying value of the property was approximately \$9.8 million, the principal balance of the debt outstanding, net of reserves held by the lender, was approximately \$14.1 million and the resulting gain on debt extinguishment was approximately \$5.3 million. The lender accepted the deed in lieu of the outstanding mortgage, and released us from our obligation.

**Table of Contents***Interest Rate Cap*

We have entered into an interest rate cap agreement with Wells Fargo that caps the interest rate on the note payable for our Champaign, Illinois property. The agreement provides that the interest rate on the note payable for our Champaign, Illinois property is capped at a certain interest rate when one-month LIBOR is in excess of 3.0%. The fair value of the interest rate cap agreement is recorded in other assets on our accompanying consolidated balance sheets. We record changes in the fair value of the interest rate cap agreement quarterly based on the current market valuations at quarter end as other income (loss) on our accompanying consolidated statements of operations. Generally, we will estimate the fair value of our interest rate cap using estimates of value provided by the counterparty and our own assumptions in the absence of observable market data, including estimated remaining life, counterparty credit risk, current market yield and interest rate spreads of similar securities as of the measurement date. At December 31, 2014 and 2013, our interest rate cap agreement was valued using Level 3 inputs. The following table summarizes the key terms of each interest rate cap agreement (dollars in thousands):

|                   |          |           |                  | As of December 31, |            | As of December 31, |            |
|-------------------|----------|-----------|------------------|--------------------|------------|--------------------|------------|
|                   | Notional |           |                  | 2014               |            | 2013               |            |
| Interest Rate Cap | Amount   | LIBOR Cap | Maturity Date    | Cost               | Fair Value | Cost               | Fair Value |
| November 26, 2013 | \$ 8,200 | 3.00%     | December 1, 2016 | \$ 31              | \$ 4       | \$ 31              | \$ 22      |

*Fair Value*

The fair value of all mortgage notes payable outstanding as of December 31, 2014, was \$476.9 million, as compared to the carrying value stated above of \$459.3 million. The fair value is calculated based on a discounted cash flow analysis, using interest rates based on management's estimate of market interest rates on long-term debt with comparable terms and loan to value ratios. The fair value was calculated using Level 3 inputs of the hierarchy established by ASC 820, Fair Value Measurements and Disclosures.

*Line of Credit*

In August 2013, we procured a \$60.0 million Line of Credit, expanded to \$75.0 million in November 2014, with KeyBank National Association (serving as a revolving lender, a letter of credit issuer and an administrative agent) and added Citizens Bank of Pennsylvania as an additional lender. Comerica Bank was subsequently added as another lender in December 2013. In March 2014, we amended our Line of Credit to extend the maturity date by one year to August 2017. We also modified certain terms under the Line of Credit, including the calculation of the total asset value and unencumbered asset value. The applicable LIBOR margins were also reduced 25 basis points at each pricing level. As a result of these modifications, the availability under our Line of Credit increased by \$1.3 million.

The Line of Credit initially matures in August 2017; however, we have a one-year extension option subject to the payment of an extension fee equal to 25 basis points on the initial maturity date and certain other customary conditions.

The Line of Credit has a letter of credit sublimit of up to \$20.0 million. In addition, we may expand the Line of Credit up to a total of \$100.0 million upon satisfaction of certain conditions and payment of the associated up front and arrangement fees at the time of such increase. The interest rate per annum applicable to the Line of Credit is equal to the London Interbank Offered Rate, or LIBOR, plus an applicable margin of up to 3.25%, depending upon our leverage. The leverage ratio used in determining the applicable margin for interest on the Line of Credit is recalculated

quarterly. We are subject to an annual maintenance fee of \$0.03 million per year and an unused commitment fee of 25 basis points per year, which accrues quarterly. 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 100% of our FFO, with acquisition-related costs required to be expensed under ASC 805 added back to FFO. In addition, the maximum amount we may draw under the Line of Credit is based on a percentage of the value of a pool of unencumbered properties, which must meet agreed upon eligibility standards.

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If and when long-term mortgages are arranged for properties in the unencumbered pool, the banks will reduce the availability under the Line of Credit by the amount advanced against that property's value. Conversely, as we purchase new properties meeting the eligibility standards, we may add these new properties to the unencumbered pool to obtain additional availability under the Line of Credit. The availability under the Line of Credit is also 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.

As of December 31, 2014, there was \$43.3 million outstanding under our Line of Credit at an interest rate of approximately 3.17% and \$4.5 million outstanding under letters of credit at a weighted average interest rate of 3.0%. As of February 18, 2015, the maximum additional amount we could draw was \$28.3 million. We were in compliance with all covenants under the Line of Credit as of December 31, 2014.

### **8. Mandatorily Redeemable Preferred Stock**

In February 2012, we completed a public offering of 1,540,000 shares of 7.125% Series C Cumulative Term Preferred Stock, par value \$0.001 per share, or the Term Preferred Stock, at a public offering price of \$25.00 per share. Gross proceeds of the offering totaled \$38.5 million and net proceeds, after deducting offering expenses borne by us, were \$36.7 million and were used to repay a portion of outstanding borrowings under our Line of Credit, for acquisitions of real estate and for working capital. The Term Preferred Stock is traded under the ticker symbol GOODN on the NASDAQ Global Select Market, or the NASDAQ. The Term Preferred Stock is not convertible into our common stock or any other security of ours. Generally, we may not redeem shares of the Term Preferred Stock prior to January 31, 2016, except in limited circumstances to preserve our status as a REIT. On or after January 31, 2016, we may redeem the shares at a redemption price of \$25.00 per share, plus any accumulated and unpaid dividends to and including the date of redemption. The shares of the Term Preferred Stock have a mandatory redemption date of January 31, 2017. We incurred \$1.8 million in total offering costs related to these transactions, which have been recorded as deferred financing costs on the consolidated balance sheet and will be amortized over the redemption period ending January 31, 2017.

The Term Preferred Stock is recorded as liability in accordance with ASC 480, Distinguishing Liabilities from Equity, which states that mandatorily redeemable financial instruments should be classified as liabilities and therefore the related dividend payments are treated as a component of interest expense in the consolidated statements of operations.

The fair value of our Term Preferred Stock as of December 31, 2014, was \$39.7 million, as compared to the carrying value stated above of \$38.5 million. The fair value is calculated based on the closing share price as of December 31, 2014 of \$25.80. The fair value was calculated using Level 1 inputs of the hierarchy established by ASC 820, Fair Value Measurements and Disclosures.

**Table of Contents****9. Commitments and Contingencies***Ground Leases*

We are obligated as lessee under three ground leases. Future minimum rental payments due under the terms of these leases as of December 31, 2014, are as follows (dollars in thousands):

| Location        | Lease End Date | For the year ended December 31, |        |        |        |        |        |            |
|-----------------|----------------|---------------------------------|--------|--------|--------|--------|--------|------------|
|                 |                | 2015                            | 2016   | 2017   | 2018   | 2019   | 2020   | Thereafter |
| Tulsa, OK       | Apr-21         | \$ 169                          | \$ 169 | \$ 169 | \$ 169 | \$ 169 | \$ 169 | \$ 85      |
| Dartmouth, MA   | May-36         | 174                             | 174    | 174    | 174    | 174    | 174    | 3,127      |
| Springfield, MA | Feb-30         | 86                              | 86     | 89     | 90     | 90     | 90     | 884        |
|                 |                | \$ 429                          | \$ 429 | \$ 432 | \$ 433 | \$ 433 | \$ 433 | \$ 4,096   |

Expenses recorded in connection to rental expense incurred for the properties listed above during the years ended December 31, 2014, 2013, and 2012 were \$0.4 million for each of the three years. Rental expenses are reflected in property operating expenses on the consolidated statements of operations.

**10. Stockholders Equity***Distributions*

Our Board of Directors declared the following distributions per share for the years ended December 31, 2014, 2013, and 2012:

|                          | For the year ended December 31, |           |                       |
|--------------------------|---------------------------------|-----------|-----------------------|
|                          | 2014                            | 2013      | 2012                  |
| Common Stock             | \$ 1.50                         | \$ 1.50   | \$ 1.50               |
| Senior Common Stock      | 1.05                            | 1.05      | 1.05                  |
| Series A Preferred Stock | 1.9374996                       | 1.9374996 | 1.9374996             |
| Series B Preferred Stock | 1.8750                          | 1.8750    | 1.8750                |
| Series C Preferred Stock | 1.7813                          | 1.7813    | 1.6328 <sup>(1)</sup> |

<sup>(1)</sup> The Series C Preferred Stock was issued on January 31, 2012.

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For federal income tax purposes, distributions paid to stockholders may be characterized as ordinary income, capital gains, return of capital or a combination of the foregoing. We had no capital gains during the last three years. The characterization of distributions during each of the last three years is reflected in the table below:

|                                      | Ordinary Income | Return of Capital |
|--------------------------------------|-----------------|-------------------|
| <b>Common Stock</b>                  |                 |                   |
| For the year ended December 31, 2012 | 0.00000%        | 100.00000%        |
| For the year ended December 31, 2013 | 18.32962%       | 81.67038%         |
| For the year ended December 31, 2014 | 0.00000%        | 100.00000%        |
| <b>Senior Common Stock</b>           |                 |                   |
| For the year ended December 31, 2012 | 0.00000%        | 100.00000%        |
| For the year ended December 31, 2013 | 100.00000%      | 0.00000%          |
| For the year ended December 31, 2014 | 0.00000%        | 100.00000%        |
| <b>Series A Preferred Stock</b>      |                 |                   |
| For the year ended December 31, 2012 | 91.70830%       | 8.29170%          |
| For the year ended December 31, 2013 | 100.00000%      | 0.00000%          |
| For the year ended December 31, 2014 | 24.10732%       | 75.89268%         |
| <b>Series B Preferred Stock</b>      |                 |                   |
| For the year ended December 31, 2012 | 91.70830%       | 8.29170%          |
| For the year ended December 31, 2013 | 100.00000%      | 0.00000%          |
| For the year ended December 31, 2014 | 24.10732%       | 75.89268%         |
| <b>Series C Preferred Stock</b>      |                 |                   |
| For the year ended December 31, 2012 | 91.70830%       | 8.29170%          |
| For the year ended December 31, 2013 | 100.00000%      | 0.00000%          |
| For the year ended December 31, 2014 | 24.10732%       | 75.89268%         |

*Recent Activity*

On June 6, 2014, we completed a public offering of 1,610,000 shares of our common stock at a public offering price of \$17.00 per share. Gross proceeds of the offering totaled \$27.4 million and net proceeds, after deducting offering expenses borne by us, were \$26.0 million, which we used to acquire real estate.

*Ongoing Activity*

On September 2, 2014, we entered into an open market sale arrangement, or the New ATM, with Cantor Fitzgerald & Co., or Cantor Fitzgerald, pursuant to which we may, from time to time, offer to sell shares of our common stock with an aggregate sales price of up to \$100.0 million on the open market through Cantor Fitzgerald, acting as sales agent and/or principal. Under the New ATM, Cantor Fitzgerald is entitled to compensation equal to up to 2.0% of the gross proceeds of the common shares it sells. During 2014, we sold a total of 1.9 million shares with aggregate net proceeds of \$32.0 million, and have a remaining capacity to sell up to \$67.5 million of common stock under the New ATM with Cantor Fitzgerald.

On August 26, 2014, we provided notice of our termination of our prior open market sale arrangement, or the Prior ATM, with Jefferies LLC, or Jefferies, under which we offered 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. From

November 2009 through August 2014, we issued and sold \$21.8 million in gross proceeds under the Prior ATM. During 2014, we raised approximately \$7.6 million in net proceeds under the Prior ATM.

In March 2011, we commenced an offering of an aggregate of 3,500,000 shares of our Senior Common Stock, par value \$0.001 per share, at a price to the public of \$15.00 per share, of which 3,000,000 shares are intended to be offered pursuant to the primary offering and 500,000 shares are intended to be offered pursuant to our senior common distribution reinvestment plan, or the DRIP. We, however, reserve the right

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to reallocate the number of shares being offered between the primary offering and the DRIP. As of December 31, 2014, we had sold 738,942 shares of Senior Common Stock in this ongoing offering, for gross proceeds of \$11.1 million, and issued an additional 24,315 shares of Senior Common Stock under the DRIP program. We have elected not to renew this offering program and it will terminate on March 28, 2015.

*Note to Employee*

The following table is a summary of the outstanding note issued to an employee of the Adviser for the exercise of stock options (dollars in thousands):

| Date Issued | Outstanding Balance                         | Outstanding Balance                         | Maturity Date<br>of Note | Interest Rate<br>on Note |
|-------------|---|---|--------------------------|--------------------------|
|             | of Employee Loan at<br>December 31,<br>2014 | of Employee Loan at<br>December 31,<br>2013 |                          |                          |
| Nov 2006    | \$ 375                                      | \$ 375                                      | Nov 2015                 | 8.15%                    |

The employee stock option program terminated in 2006. 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, this note was recorded as a full recourse loan to the employee and is included in the equity section of the accompanying consolidated balance sheets. As of December 31, 2014, this loan maintained its full recourse status.

**Table of Contents****11. Quarterly Financial Information (unaudited)**

The following table reflects the quarterly results of operations for the years ended December 31, 2014 and 2013 (dollars in thousands).

|  | Quarter ended        |                    |               |                         |
|--|----------------------|--------------------|---------------|-------------------------|
|  | December 31, 2014    | September 30, 2014 | June 30, 2014 | March 31, 2014          |
| Operating revenues   | \$ 19,216            | \$ 19,014          | \$ 18,390     | \$ 17,136               |
| Operating expenses   | 10,970               | 11,457             | 11,243        | 23,736                  |
| Other expense  | (2,082)              | (7,328)            | (5,928)       | (6,914)                 |
| Net income (loss)  | 6,164                | 229                | 1,219         | (13,514)                |
| Dividends attributable to preferred and senior common stock          | (1,220)              | (1,160)            | (1,133)       | (1,123)                 |
| Net income (loss) available to common stockholders                   | 4,944 <sup>(1)</sup> | (931)              | 86            | (14,637) <sup>(2)</sup> |
| Net income (loss) available to common stockholders - basic & diluted | \$ 0.36              | \$ (0.05)          | \$ 0.01       | \$ (0.93)               |

|   | Quarter ended     |                    |               |                |
|---|-------------------|--------------------|---------------|----------------|
|   | December 31, 2013 | September 30, 2013 | June 30, 2013 | March 31, 2013 |
| Operating revenues  | \$ 16,860         | \$ 16,190          | \$ 14,258     | \$ 14,035      |
| Operating expenses  | 9,542             | 8,639              | 7,369         | 7,273          |
| Other expense   | (6,984)           | (7,242)            | (6,438)       | (6,329)        |
| Net income  | 334               | 309                | 451           | 433            |
| Dividends attributable to preferred and senior common stock | (1,120)           | (1,106)            | (1,092)       | (1,076)        |
| Net loss available to common stockholders                   | (786)             | (797)              | (641)         | (643)          |
| Net loss available to common stockholders - basic & diluted | \$ (0.05)         | \$ (0.06)          | \$ (0.05)     | \$ (0.06)      |

(1) Includes a \$5.3 million gain on debt extinguishment recorded during the three months ended December 31, 2014.

(2) Includes a \$14.0 million impairment loss recorded during the three months ended March 31, 2014.

**12. Subsequent Events**

On January 13, 2015, our Board of Directors declared the following monthly distributions:

| Record Date       | Payment Date      | Common Stock Distributions per Share | Series A Preferred Distributions per Share | Series B Preferred Distributions per Share | Series C Preferred Distributions per Share |
|-------------------|-------------------|--------------------------------------|--|--|--|
| January 23, 2015  | February 3, 2015  | \$ 0.125                             | \$ 0.1614583                               | \$ 0.15625                                 | \$ 0.1484375                               |
| February 18, 2015 | February 27, 2015 | 0.125                                | 0.1614583                                  | 0.15625                                    | 0.1484375                                  |
| March 20, 2015    | March 31, 2015    | 0.125                                | 0.1614583                                  | 0.15625                                    | 0.1484375                                  |
| Total             |                   | \$ 0.375                             | \$ 0.4843749                               | \$ 0.46875                                 | \$ 0.4453125                               |

## Senior Common Stock Distributions

Payable to the

Holders of Record

| During the Month of: | Payment Date     | Distribution per Share |
|----------------------|------------------|------------------------|
| January              | February 6, 2015 | \$ 0.0875              |
| February             | March 6, 2015    | 0.0875                 |
| March                | April 7, 2015    | 0.0875                 |
| Total                |                  | \$ 0.2625              |

On February 9, 2015, we modified the leases with the tenant occupying two of our properties located in Raleigh, North Carolina. The leases covering these properties were extended for an additional five years through July 2020. Both leases were originally set to expire in July 2015. The tenant was previously fully occupying both buildings, totaling 174,426 square feet, but had reduced their space requirement in one of

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their buildings by 94,200 square feet. Both leases contain prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately \$0.9 million, as compared to annualized straight line rents of \$1.3 million under the previous terms of the lease. In connection with the extension of the lease and modification of certain terms of the lease, we anticipate paying \$0.2 million in leasing commissions, and committed to \$0.1 million in tenant improvements.

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## GLADSTONE COMMERCIAL CORPORATION

## SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION

DECEMBER 31, 2014 (Dollars in Thousands)

| Description of Property             | Encumbrances | Initial Cost |              |                                      | Total Cost |              |                                       | Accumulated Depreciation | Net Real Estate | Year Construction/Improvements | Date Acquired |
|-------------------------------------|--------------|--------------|--------------|--------------------------------------|------------|--------------|---------------------------------------|--------------------------|-----------------|--------------------------------|---------------|
|                                     |              | Land         | Improvements | Building & Subsequent to Acquisition | Land       | Improvements | Buildings & Subsequent to Acquisition |                          |                 |                                |               |
| Building, North Carolina            | \$ 4,796     | \$ 960       | \$ 4,481     | \$                                   | \$ 960     | \$ 4,481     | \$ 5,441                              | \$ 1,773                 | \$ 3,668        | 1997                           | 12/23/        |
| Building, Ohio                      | 2,664        | 186          | 3,083        | 500                                  | 186        | 3,583        | 3,769                                 | 972                      | 2,797           | 1994                           | 1/30/         |
| Building, North Carolina            | 6,828        | 1,973        | 6,771        | 1,279                                | 1,973      | 8,050        | 10,023                                | 1,916                    | 8,107           | 1968/1999                      | 4/29/         |
| Building, North Carolina            | 6,308        | 740          | 8,423        | 61                                   | 740        | 8,484        | 9,224                                 | 2,319                    | 6,905           | 1984/1995                      | 6/30/         |
| Commercial Building, Pennsylvania   | 3,652        | 150          | 5,050        | 7,285                                | 150        | 12,335       | 12,485                                | 1,401                    | 11,084          | 1998/2014                      | 7/6/          |
| Commercial Building, North Carolina | 5,176        | 100          | 6,574        | 269                                  | 100        | 6,843        | 6,943                                 | 1,800                    | 5,143           | 1991                           | 8/5/          |
| Commercial Building, Texas          | 2,636        | 820          | 2,107        | 69                                   | 820        | 2,176        | 2,996                                 | 584                      | 2,412           | 1986                           | 8/5/          |
| Building, Cocono, Pennsylvania      | 6,500        | 1,000        | 6,296        | 1,396                                | 1,000      | 7,692        | 8,692                                 | 1,726                    | 6,966           | 2001                           | 9/16/         |
| Commercial Building, Antonio, Texas | 4,889        | 350          | 5,819        | 18                                   | 350        | 5,837        | 6,187                                 | 1,551                    | 4,636           | 1995/1999                      | 10/15/        |
|                                     | 6,643        | 843          | 7,514        | 621                                  | 843        | 8,135        | 8,978                                 | 2,389                    | 6,589           | 1999                           | 2/10/         |

|                                   |        |       |        |       |       |        |        |       |        |                |       |
|-----------------------------------|--------|-------|--------|-------|-------|--------|--------|-------|--------|----------------|-------|
| Building<br>bus, Ohio             |        |       |        |       |       |        |        |       |        |                |       |
| erial Building<br>ats, New York   | 2,516  | 410   | 2,385  |       | 410   | 2,385  | 2,795  | 610   | 2,185  | 1995           | 2/10/ |
| erial Building<br>ta, Kansas      | 5,365  | 275   | 6,459  | 34    | 275   | 6,493  | 6,768  | 1,623 | 5,145  | 2001           | 4/15/ |
| Building<br>ton, Texas            | 7,466  | 1,525 | 9,703  | 77    | 1,525 | 9,780  | 11,305 | 2,510 | 8,795  | 2000           | 5/18/ |
| erial Building<br>n, Ohio         | 3,814  | 636   | 3,695  | 416   | 636   | 4,111  | 4,747  | 1,012 | 3,735  | 1966           | 5/26/ |
| Building<br>own, New              | 1,877  | 525   | 1,877  | 120   | 525   | 1,997  | 2,522  | 820   | 1,702  | 1956           | 6/30/ |
| Building<br>in Township,<br>ersey | 4,365  | 1,351 | 3,520  | 534   | 1,351 | 4,054  | 5,405  | 1,012 | 4,393  | 1991           | 7/7/  |
| erial Building<br>n, South<br>na  | 6,471  | 1,632 | 6,200  |       | 1,632 | 6,200  | 7,832  | 1,514 | 6,318  | 1978           | 7/11/ |
| erial Building<br>n, South<br>na  | 10,375 | 783   | 10,790 | 1,615 | 783   | 12,405 | 13,188 | 2,979 | 10,209 | 1984/2001/2007 | 7/14/ |
| erial Building<br>wood, Missouri  | 2,579  | 195   | 2,682  | 419   | 195   | 3,101  | 3,296  | 740   | 2,556  | 1984/2001/2007 | 7/14/ |
| erial Building                    | 2,291  | 763   | 2,309  | 683   | 763   | 2,992  | 3,755  | 642   | 3,113  | 1977           | 8/5/  |

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## GLADSTONE COMMERCIAL CORPORATION

## SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION (Continued)

DECEMBER 31, 2014 (Dollars in Thousands)

| Description of Property                      | Initial Cost |              |                                      |                               | Total Cost |              |                                       |        | Accumulated Depreciation | Net Real Estate | Year Construction/Improvements | Date Acquired |
|--|--------------|--------------|--------------------------------------|-------------------------------|------------|--------------|---------------------------------------|--------|--------------------------|-----------------|--------------------------------|---------------|
|  | Land         | Improvements | Building & Subsequent to Acquisition | Improvement Costs Capitalized | Land       | Improvements | Buildings & Subsequent to Acquisition | Total  |                          |                 |                                |               |
| Commercial Building, Indianapolis, Indiana   | \$ 626       | \$ 66        | \$ 1,075                             | \$ 49                         | \$ 66      | \$ 1,124     | \$ 1,190                              | \$ 271 | \$ 919                   | 1982            | 9/2/78                         |               |
| Commercial Building, Falls, Illinois         | 601          | 132          | 1,130                                | 51                            | 132        | 1,181        | 1,313                                 | 421    | 892                      | 1998            | 9/2/78                         |               |
| Commercial Building, Weymouth, Massachusetts | 626          | 35           | 1,113                                | 50                            | 35         | 1,163        | 1,198                                 | 144    | 1,054                    | 1988            | 9/2/78                         |               |
| Commercial Building, Kenosha, Wisconsin      | 6,276        | 629          | 6,504                                | 1,847                         | 629        | 8,351        | 8,980                                 | 1,873  | 7,107                    | 1994            | 10/17/78                       |               |
| Commercial Building, The Heights, Ohio       | 2,997        | 55           | 4,717                                | 3,250                         | 55         | 7,967        | 8,022                                 | 1,316  | 6,706                    | 1992/2013       | 10/31/78                       |               |
| Commercial Building, Richmond, Virginia      | 9,790        | 1,609        | 10,065                               | 1,221                         | 1,609      | 11,286       | 12,895                                | 3,237  | 9,658                    | 1974            | 12/21/78                       |               |
| Commercial Building, Columbus, Ohio Medical  | 5,275        | 736          | 5,336                                | 36                            | 736        | 5,372        | 6,108                                 | 1,286  | 4,822                    | 1972            | 12/30/78                       |               |
| Commercial Building, Hadley, Massachusetts   | 2,750        | 263          | 2,812                                | 390                           | 263        | 3,202        | 3,465                                 | 736    | 2,729                    | 1979            | 12/30/78                       |               |
| Commercial Building, Springfield, Illinois   |              | 471          | 2,765                                | 71                            | 471        | 2,836        | 3,307                                 | 637    | 2,670                    | 1978            | 2/15/78                        |               |
| Commercial Building, Springfield, Illinois   | 1,545        | 687          | 2,036                                | 2                             | 687        | 2,038        | 2,725                                 | 495    | 2,230                    | 1996            | 2/21/78                        |               |
| Commercial Building, Springfield, Illinois   | 3,030        | 1,347        | 3,992                                | 4                             | 1,347      | 3,996        | 5,343                                 | 971    | 4,372                    | 1996            | 2/21/78                        |               |

|                              |        |       |       |       |       |        |        |       |        |           |        |
|------------------------------|--------|-------|-------|-------|-------|--------|--------|-------|--------|-----------|--------|
| Building                     |        |       |       |       |       |        |        |       |        |           |        |
| ampaign, Illinois            |        |       |       |       |       |        |        |       |        |           |        |
| Building                     | 1,894  | 842   | 2,495 | 2     | 842   | 2,497  | 3,339  | 607   | 2,732  | 1996      | 2/21/2 |
| ampaign, Illinois            |        |       |       |       |       |        |        |       |        |           |        |
| Building                     | 1,731  | 770   | 2,281 | 2     | 770   | 2,283  | 3,053  | 555   | 2,498  | 1996      | 2/21/2 |
| ville, Minnesota             |        |       |       |       |       |        |        |       |        |           |        |
| Building                     | 11,001 | 3,511 | 8,746 | 3,525 | 3,511 | 12,271 | 15,782 | 2,515 | 13,267 | 1984      | 5/10/2 |
| omonee Falls,<br>consin      |        |       |       |       |       |        |        |       |        |           |        |
| erial Building               | 6,738  | 625   | 6,911 | 57    | 625   | 6,968  | 7,593  | 1,553 | 6,040  | 1986/2000 | 6/30/2 |
| own, Texas<br>cal            |        |       |       |       |       |        |        |       |        |           |        |
| Building                     | 2,000  | 221   | 2,443 |       | 221   | 2,443  | 2,664  | 593   | 2,071  | 1997      | 7/11/2 |
| ingham,<br>ma <sup>(3)</sup> |        |       |       |       |       |        |        |       |        |           |        |
| erial Building               |        | 612   | 2,326 |       | 612   | 2,326  | 2,938  | 504   | 2,434  | 1961/1980 | 9/29/2 |
| gomery,<br>ma <sup>(3)</sup> |        |       |       |       |       |        |        |       |        |           |        |
| erial Building               |        | 222   | 844   |       | 222   | 844    | 1,066  | 183   | 883    | 1962/1989 | 9/29/2 |

**Table of Contents****GLADSTONE COMMERCIAL CORPORATION****SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION (Continued)****DECEMBER 31, 2014 (Dollars in Thousands)**

| Description of Property                           | Initial Cost |        |              |                                      | Total Cost |              |        | Accumulated Depreciation | Net Real Estate | Year Construction/Improvements | Date Acquired |
|---|--------------|--------|--------------|--------------------------------------|------------|--------------|--------|--------------------------|-----------------|--------------------------------|---------------|
|   | Encumbrance  | Land   | Improvements | Building & Subsequent to Acquisition | Land       | Improvements | Total  |                          |                 |                                |               |
| Commercial Building, Missouri                     |              |        |              |                                      |            |              |        |                          |                 |                                |               |
| Commercial Building, Ohio                         | \$           | \$ 146 | \$ 555       | \$                                   | \$ 146     | \$ 555       | \$ 701 | \$ 120                   | \$ 581          | 1978                           | 9/29/2002     |
| Commercial Building, North Carolina               | 4,250        | 797    | 6,258        | 540                                  | 797        | 6,798        | 7,595  | 1,563                    | 6,032           | 2002                           | 1/5/2002      |
| Commercial Building, Oklahoma                     | 5,164        | 1,606  | 5,513        |                                      | 1,606      | 5,513        | 7,119  | 1,142                    | 5,977           | 1994                           | 2/16/2002     |
| Commercial Building, Florida <sup>(3)</sup>       | 7,776        |        | 14,057       |                                      |            | 14,057       | 14,057 | 3,312                    | 10,745          | 2004                           | 3/1/2002      |
| Commercial Building, Massachusetts <sup>(3)</sup> |              | 3,562  | 6,672        | 685                                  | 3,562      | 7,357        | 10,919 | 1,435                    | 9,484           | 1956/1992                      | 3/9/2002      |
| Commercial Building, Ohio                         |              | 1,395  | 8,893        |                                      | 1,395      | 8,893        | 10,288 | 1,882                    | 8,406           | 1985/1989                      | 5/17/2002     |
| Commercial Building, New York                     | 4,555        | 1,201  | 4,961        |                                      | 1,201      | 4,961        | 6,162  | 969                      | 5,193           | 2007                           | 7/1/2002      |
| Commercial Building, Michigan                     | 3,964        | 299    | 5,019        |                                      | 299        | 5,019        | 5,318  | 942                      | 4,376           | 2005                           | 9/6/2002      |
| Commercial Building, Illinois                     | 5,831        | 1,629  | 10,500       | 37                                   | 1,629      | 10,537       | 12,166 | 2,055                    | 10,111          | 2001                           | 9/28/2002     |
| Commercial Building                               |              | 1,272  | 5,003        | 475                                  | 1,272      | 5,478        | 6,750  | 993                      | 5,757           | 2002                           | 9/28/2002     |

|                                 |       |       |       |       |       |       |       |       |       |           |            |
|---------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-----------|------------|
| Atlanta, Georgia <sup>(3)</sup> |       |       |       |       |       |       |       |       |       |           |            |
| Atlanta Office Building         | 784   | 3,245 |       |       | 784   | 3,245 | 4,029 | 653   | 3,376 | 1989      | 12/13/2006 |
| Atlanta, Georgia <sup>(3)</sup> |       |       |       |       |       |       |       |       |       |           |            |
| Atlanta Office Building         | 205   | 848   |       |       | 205   | 848   | 1,053 | 171   | 882   | 1989      | 12/13/2006 |
| Atlanta, Georgia <sup>(3)</sup> |       |       |       |       |       |       |       |       |       |           |            |
| Atlanta Office Building         | 257   | 1,064 |       |       | 257   | 1,064 | 1,321 | 214   | 1,107 | 1989      | 12/13/2006 |
| Atlanta, Georgia <sup>(3)</sup> |       |       |       |       |       |       |       |       |       |           |            |
| Atlanta Office Building         | 679   | 2,809 |       |       | 679   | 2,809 | 3,488 | 565   | 2,923 | 2005      | 12/13/2006 |
| Atlanta, Georgia <sup>(3)</sup> |       |       |       |       |       |       |       |       |       |           |            |
| Atlanta Office Building         | 176   | 729   |       |       | 176   | 729   | 905   | 147   | 758   | 1986      | 12/13/2006 |
| Atlanta, Georgia <sup>(3)</sup> |       |       |       |       |       |       |       |       |       |           |            |
| Atlanta Office Building         | 232   | 959   |       |       | 232   | 959   | 1,191 | 193   | 998   | 2000      | 12/13/2006 |
| Atlanta, Georgia <sup>(3)</sup> |       |       |       |       |       |       |       |       |       |           |            |
| Atlanta Office Building         | 3,145 | 738   | 3,055 | 2,511 | 738   | 5,566 | 6,304 | 615   | 5,689 | 2004      | 12/13/2006 |
| Atlanta, Georgia <sup>(3)</sup> |       |       |       |       |       |       |       |       |       |           |            |
| Atlanta Office Building         | 297   | 1,228 |       |       | 297   | 1,228 | 1,525 | 247   | 1,278 | 1994      | 12/13/2006 |
| Atlanta, Georgia <sup>(3)</sup> |       |       |       |       |       |       |       |       |       |           |            |
| Atlanta Office Building         | 3,983 | 491   | 6,202 |       | 491   | 6,202 | 6,693 | 1,104 | 5,589 | 2007      | 1/29/2006  |
| Atlanta, Georgia <sup>(3)</sup> |       |       |       |       |       |       |       |       |       |           |            |
| Atlanta Office Building         | 5,121 | 1,354 | 8,074 | 397   | 1,381 | 8,444 | 9,825 | 1,816 | 8,009 | 1985/2006 | 2/26/2006  |

**Table of Contents****GLADSTONE COMMERCIAL CORPORATION****SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION (Continued)****DECEMBER 31, 2014 (Dollars in Thousands)**

| Description of Property                         | Encumbrances | Initial Cost |   |         | Total Cost   |           |           | Accumulated Depreciation | Net Real Estate | Year Construction/Improvements | Date Acquired |
|---|--------------|--------------|---|---------|--------------|-----------|-----------|--------------------------|-----------------|--------------------------------|---------------|
|   |              | Land         | Improvement Costs Capitalized Buildings & Subsequent to Acquisition | Land    | Improvements | Total     |           |                          |                 |                                |               |
| Property located in Ford Township, (3)          |              |              |   |         |              |           |           |                          |                 |                                |               |
| Office Building<br>Raleigh, North Carolina      | \$           | \$ 1,796     | \$ 11,154   | \$ (11) | \$ 1,785     | \$ 11,154 | \$ 12,939 | \$ 2,048                 | \$ 10,891       | 1957/2008                      | 3/31/2008     |
| Industrial Building<br>Cincinnati, Ohio         | 2,315        | 669          | 3,028   | 6       | 669          | 3,034     | 3,703     | 535                      | 3,168           | 1985                           | 4/30/2008     |
| Industrial Building<br>Pottsville, Pennsylvania | 5,650        | 829          | 6,607   | 209     | 829          | 6,816     | 7,645     | 1,106                    | 6,539           | 1992/2007                      | 8/29/2007     |
| Industrial Building<br>Des Moines, Iowa         | 5,510        | 1,249        | 6,420   | 171     | 1,249        | 6,591     | 7,840     | 1,270                    | 6,570           | 1987                           | 8/29/2007     |
| Industrial Building<br>Raleigh, North Carolina  | 9,015        | 258          | 5,861   |         | 258          | 5,861     | 6,119     | 743                      | 5,376           | 1990                           | 12/15/2008    |
| Office Building<br>Springfield, Missouri        | 6,697        | 1,163        | 6,605   |         | 1,163        | 6,605     | 7,768     | 1,124                    | 6,644           | 2008                           | 4/4/2008      |
| Office Building<br>Columbus, Ohio               | 10,977       | 1,700        | 12,038  |         | 1,700        | 12,038    | 13,738    | 1,278                    | 12,460          | 2006                           | 6/20/2006     |
| Office Building<br>Springfield, New York        | 2,646        | 449          | 3,010   |         | 449          | 3,010     | 3,459     | 427                      | 3,032           | 2011                           | 10/20/2011    |
| Office Building<br>Boston, Massachusetts        | 6,799        | 1,696        | 7,077   | 81      | 1,696        | 7,158     | 8,854     | 855                      | 7,999           | 1984                           | 10/28/2008    |
|   | 4,049        |              | 4,236   |         |              | 4,236     | 4,236     | 368                      | 3,868           | 2011                           | 11/18/2011    |

|  |        |       |        |     |       |        |        |       |        |      |            |
|--|--------|-------|--------|-----|-------|--------|--------|-------|--------|------|------------|
| Industrial Location<br>Springfield, Missouri       |        |       |        |     |       |        |        |       |        |      |            |
| Industrial Location<br>Pittsburgh,<br>Pennsylvania | 1,823  |       | 2,275  |     |       | 2,275  | 2,275  | 250   | 2,025  | 2005 | 12/13/2005 |
| Industrial Building<br>Farmington, Virginia        | 2,757  | 281   | 3,205  |     | 281   | 3,205  | 3,486  | 311   | 3,175  | 1968 | 12/28/2005 |
| Industrial Building<br>Des Moines, Iowa            | 7,223  | 706   | 7,858  |     | 706   | 7,858  | 8,564  | 767   | 7,797  | 2002 | 1/25/2005  |
| Industrial Building<br>Albany, Ohio                | 4,426  | 212   | 5,072  | 287 | 212   | 5,359  | 5,571  | 499   | 5,072  | 1970 | 5/30/2005  |
| Industrial Building<br>Columbus, Georgia           | 9,066  | 1,658 | 8,746  |     | 1,658 | 8,746  | 10,404 | 831   | 9,573  | 2007 | 6/5/2005   |
| Industrial Building<br>Columbus, Ohio              | 4,507  | 1,378 | 4,520  |     | 1,378 | 4,520  | 5,898  | 471   | 5,427  | 2012 | 6/21/2005  |
| Industrial Building<br>Tallahassee, Florida        | 2,845  | 542   | 2,453  | 11  | 542   | 2,464  | 3,006  | 287   | 2,719  | 1981 | 6/28/2005  |
| Industrial Building<br>Ft. Worth, Texas            | 10,252 | 1,160 | 11,994 |     | 1,160 | 11,994 | 13,154 | 827   | 12,327 | 2011 | 9/26/2005  |
| Industrial Building<br>Columbia, South Carolina    | 13,567 | 963   | 15,647 |     | 963   | 15,647 | 16,610 | 1,022 | 15,588 | 2005 | 11/8/2005  |
| Industrial Building<br>Columbus, Ohio              | 18,067 | 1,905 | 20,648 |     | 1,905 | 20,648 | 22,553 | 1,864 | 20,689 | 2010 | 11/21/2005 |

**Table of Contents****GLADSTONE COMMERCIAL CORPORATION****SCHEDULE III REAL ESTATE AND ACCUMULATED DEPRECIATION (Continued)****DECEMBER 31, 2014 (Dollars in Thousands)**

| Description of Property   | Encumbrances | Initial Cost |              | Improvement Costs Capitalized                   |          | Total Cost   |          | Accumulated Depreciation | Net Real Estate | Year Construction/Improvements | A |
|---------------------------|--------------|--------------|--------------|---|----------|--------------|----------|--------------------------|-----------------|--------------------------------|---|
|                           |              | Land         | Improvements | Buildings & Buildings Subsequent to Acquisition | Land     | Improvements | Total    |                          |                 |                                |   |
| Building, New<br>Iowa (3) | \$ 3,551     | \$ 1,627     | \$ 3,017     | \$ 236  | \$ 1,627 | 3,253        | \$ 4,880 | \$ 201                   | \$ 4,679        | 1985                           |   |
| Building<br>Minnesota     |              | 457          | 10,529       |   | 457      | 10,529       | 10,986   | 604                      | 10,382          | 2013                           |   |
| Building<br>Texas         | 8,045        | 1,060        | 10,519       |   | 1,060    | 10,519       | 11,579   | 748                      | 10,831          | 2009                           |   |
| Building<br>Texas         | 34,567       | 2,330        | 44,021       | 122   | 2,330    | 44,143       | 46,473   | 3,071                    | 43,402          | 1999                           |   |
| Building<br>Colorado      | 8,704        | 2,699        | 7,945        |   | 2,699    | 7,945        | 10,644   | 602                      | 10,042          | 1998                           |   |
| Building<br>Michigan      | 11,315       | 1,503        | 11,739       |   | 1,503    | 11,739       | 13,242   | 546                      | 12,696          | 2008                           | 1 |
| Building<br>Texas         | 4,297        | 352          | 5,626        |   | 352      | 5,626        | 5,978    | 197                      | 5,781           | 1988                           | 1 |
| Building<br>Texas         | 3,417        | 874          | 3,634        |   | 874      | 3,634        | 4,508    | 95                       | 4,413           | 2004                           |   |
| Building<br>Tennessee     | 2,797        | 1,277        | 2,424        |   | 1,277    | 2,424        | 3,701    | 72                       | 3,629           | 2000                           |   |
| Building<br>Texas         | 4,935        | 752          | 6,176        |   | 752      | 6,176        | 6,928    | 150                      | 6,778           | 1986                           |   |
| Building<br>Texas         | 3,767        | 1,448        | 3,349        |   | 1,448    | 3,349        | 4,797    | 74                       | 4,723           | 2005                           |   |

|                                     |            |           |            |           |           |            |            |           |            |           |   |
|-------------------------------------|------------|-----------|------------|-----------|-----------|------------|------------|-----------|------------|-----------|---|
| Building<br>Ohio <sup>(3)</sup>     |            | 990       | 8,017      |           | 990       | 8,017      | 9,007      | 266       | 8,741      | 1986      |   |
| Building<br>Pennsylvania            |            |           |            |           |           |            |            |           |            |           |   |
| Building<br>Colorado <sup>(3)</sup> | 22,600     | 3,102     | 25,405     |           | 3,102     | 25,405     | 28,507     | 451       | 28,056     | 2000/2006 |   |
| Building<br>S, Indiana              |            | 2,882     | 4,013      |           | 2,882     | 4,013      | 6,895      | 82        | 6,813      | 1983      |   |
| Building<br>Colorado <sup>(3)</sup> | 6,100      | 502       | 6,490      |           | 502       | 6,490      | 6,992      | 99        | 6,893      | 1981/2014 |   |
| Building<br>Michigan                |            | 1,621     | 7,314      |           | 1,621     | 7,314      | 8,935      | 46        | 8,889      | 1985      | 1 |
| Building<br>Michigan                | 10,839     | 658       | 14,607     |           | 658       | 14,607     | 15,265     | 11        | 15,254     | 2004      | 1 |
| Building                            | 7,587      | 460       | 10,225     |           | 460       | 10,225     | 10,685     | 7         | 10,678     | 2004      | 1 |
|                                     | \$ 458,592 | \$ 88,378 | \$ 602,477 | \$ 31,710 | \$ 88,394 | \$ 634,171 | \$ 722,565 | \$ 92,133 | \$ 630,432 |           |   |

- (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.
- (3) These properties are in our unencumbered pool of assets on our Line of Credit.

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The following table reconciles the change in the balance of real estate during the years ended December 31, 2014, 2013 and 2012, respectively (in thousands):

|                                | 2014       | 2013       | 2012       |
|--------------------------------|------------|------------|------------|
| Balance at beginning of period | \$ 642,353 | \$ 533,753 | \$ 442,521 |
| <b>Additions:</b>              |            |            |            |
| Acquisitions during period     | 105,813    | 103,424    | 85,462     |
| Improvements                   | 13,889     | 5,176      | 5,770      |
| <b>Deductions:</b>             |            |            |            |
| Dispositions during period     | (39,490)   |            |            |
| Balance at end of period       | \$ 722,565 | \$ 642,353 | \$ 533,753 |

The following table reconciles the change in the balance of accumulated depreciation during the years ended December 31, 2014, 2013 and 2012, respectively (in thousands):

|                                | 2014      | 2013      | 2012      |
|--------------------------------|-----------|-----------|-----------|
| Balance at beginning of period | \$ 81,241 | \$ 65,730 | \$ 53,784 |
| Additions during period        | 18,814    | 15,511    | 11,946    |
| Dispositions during period     | (7,922)   |           |           |
| Balance at end of period       | \$ 92,133 | \$ 81,241 | \$ 65,730 |

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## GLADSTONE COMMERCIAL CORPORATION

## SCHEDULE IV MORTGAGE LOANS ON REAL ESTATE

DECEMBER 31, 2014

(Dollars in Thousands)

| Location and Type of Real Estate                       | Type of Loan    | Interest Rate  | Final Maturity Date | Periodic Payment Terms  | Face Amount | Principal Amount | Delinquent |
|--|-----------------|--|---------------------|---|-------------|------------------|------------|
| Phoenix, Arizona;<br>Build-to-Suit Healthcare Facility | Second Mortgage | 9% Current Interest,<br>22% internal rate of<br>return on exit | 7/31/2016           | 9.0% interest, paid currently in cash on the loan during construction and through maturity. Exit fee upon maturity of the loan in an amount sufficient to earn a 22% internal rate of return. | \$ 5,600    | \$ 5,600         | \$ 5,600   |
|  |                 |  |                     |   | \$ 5,600    | \$ 5,600         | \$ 5,600   |

The following table reconciles the change in the balance of mortgage loans on real estate during the years ended December 31, 2014, 2013 and 2012, respectively:

|                                | 2014     | 2013 | 2012 |
|--------------------------------|----------|------|------|
| Balance at beginning of period | \$       | \$   | \$   |
| New mortgage loans             | 5,600    |      |      |
| Collections of principal       |          |      |      |
| Balance at end of period       | \$ 5,600 | \$   | \$   |

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**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, 2014, 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, 2014 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, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information.**

None.

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**Part III**

We will file a definitive Proxy Statement for our 2015 Annual Meeting of Stockholders (the 2015 Proxy Statement ) with the Securities and Exchange Commission, pursuant to Regulation 14A, not later than 120 days after December 31, 2014. Accordingly, certain information required by Part III has been omitted under General Instruction G(3) to Form 10-K. Only those sections of the 2015 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 2015 Proxy Statement under the captions Election of Directors to Class of 2018, Information Regarding the Board of Directors and Corporate Governance, Compensation Committee Report, and Section 16(a) Beneficial Ownership Reporting Compliance, and sub-caption Code of Business Conduct and Ethics.

**Item 11. Executive Compensation.**

The information required by Item 11 is hereby incorporated by reference from our 2015 Proxy Statement under the captions Executive Compensation, Director Compensation, and Compensation Committee Report, and sub-caption Compensation Committee Interlocks and Insider Participation.

**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 2015 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 2015 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 2015 Proxy Statement under the sub-captions Independent Registered Public Accounting Firm Fees and Pre-Approval Policy and Procedures under the caption Ratification of Selection of Independent Registered Public Accounting Firm.

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**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, 2014 and 2013

Consolidated Statements of Operations for the years ended December 31, 2014, 2013 and 2012

Consolidated Statements of Stockholders' Equity for the years ended December 31, 2014, 2013 and 2012

Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012

Notes to Financial Statements

2. Financial statement schedules

Schedule III Real Estate and Accumulated Depreciation 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 Restatement, incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q (File No. 001-33097), filed April 30, 2012.  |
| 3.2                   | Bylaws of the Registrant, incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-11 (File No. 333-106024), filed June 11, 2003.   |
| 3.3                   | First Amendment to Bylaws of the Registrant, incorporated by reference to Exhibit 99.1 of the Registrant's Current Report on Form 8-K (File No. 001-33097), filed July 10, 2007.   |
| 4.1                   | Form of Certificate for Common Stock of the Registrant, incorporated by reference to Exhibit 4.1 to the Registrant's 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 the Registrant, incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-A12G (File No. 000-50363), filed January 19, 2006.   |
| 4.3                   | Form of Certificate for 7.50% Series B Cumulative Redeemable Preferred Stock of the Registrant, incorporated by reference to Exhibit 4.2 to the Registrant's Form 8-A12B (File No. 001-33097), filed October 19, 2006.   |
| 4.4                   | Form of Certificate for 7.125% Series C Cumulative Term Preferred Stock of the Registrant, incorporated by reference to Exhibit 4.4 to the Registrant's Current Report on Form 8-A12B (File No. 001-33097), filed January 31, 2012.  |
| 10.1                  | First Amended and Restated Agreement of Limited Partnership of Gladstone Commercial Limited Partnership, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 000-50363), filed February 1, 2006.  |
| 10.2                  | 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 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed October 25, 2006. |
| 10.3                  | Amended and Restated Investment Advisory Agreement between the Registrant and Gladstone Management Corporation, dated January 1, 2007, incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed January 3, 2007.   |
| 10.4                  | Administration Agreement between the Registrant and Gladstone Administration, LLC, dated January 1, 2007, incorporated by reference to Exhibit 99.2 of the Registrant's Current Report on Form 8-K (File No. 001-33097), filed January 3, 2007.  |
| 10.5                  | Amendment to First Amended and Restated Agreement of Limited Partnership of Gladstone Commercial Limited Partnership, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed April 29, 2010.   |
| 10.6                  | 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 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed April 29, 2010.                                    |

- 10.7 Second Amendment to First Amended and Restated Agreement of Limited Partnership of Gladstone Commercial Limited Partnership, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed February 3, 2012.
- 10.8 Gladstone Commercial Limited Partnership Schedule 4.2(a)(4) to First Amended and Restated Agreement of Limited Partnership Designation of 7.125% Series C Cumulative Term Preferred Units, incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed February 3, 2012.

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- 10.9 Agreement of Purchase and Sale and Joint Escrow Instructions, by and between Gladstone Commercial Limited Partnership and Karlin Parmer Office, LLC, dated May 20, 2013, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed June 14, 2013.
- 10.10 Loan Agreement between NH10 CUMMING GA LLC, D08 MARIETTA OH LLC, MPI06 MASON OH LLC, SRFF08 READING PA, L.P., RPT08 PINEVILLE NC, L.P., IPA12 ASHBURN VA SPE LLC, and FTCHI07 GRAND RAPIDS MI LLC and KeyBank National Association, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed October 3, 2012.
- 10.11 Promissory Note in favor of KeyBank National Association, dated as of October 1, 2012 (File No. 001-33097), incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed October 3, 2012.
- 10.12 Guaranty Agreement, dated as of October 1, 2012 between the Registrant and KeyBank National Association, incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed October 3, 2012.
- 10.13 Credit Agreement, dated as of August 7, 2013, by and among Gladstone Commercial Limited Partnership, the Registrant, each of the financial institutions initially a signatory thereto together with their successors and assignees and KeyBank National Association, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed August 9, 2013.
- 10.14 Unconditional Guaranty of Payment and Performance, dated as of August 7, 2013, by the Registrant, AL13 Brookwood LLC, CMS06-3 LLC, EI07 Tewksbury MA LLC, NJT06 Sterling Heights MI LLC, RB08 Concord OH LLC, DBPI07 Bolingbrook IL LLC, RCOG07 Georgia LLC, APML07 Hialeah FL LLC for the benefit of KeyBank National Association, incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed August 9, 2013.
- 10.15 First Amendment to Credit Agreement, dated as of March 28, 2014, by and among Gladstone Commercial Limited Partnership, the Registrant and certain of its wholly owned subsidiaries, each of the financial institutions initially a signatory thereto together with their successors and assignees and KeyBank National Association, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed March 31, 2014.
- 10.16 Controlled Equity Offering Sales Agreement, dated September 2, 2014, by and among the Registrant, Gladstone Commercial Limited Partnership, and Cantor Fitzgerald & Co., incorporated by reference to Exhibit 1.1 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed September 2, 2014.
- 10.17 Second Amendment to Credit Agreement and Unconditional Guaranty of Payment and Performance, dated as of November 20, 2014, by and among Gladstone Commercial Limited Partnership, the Registrant and certain of its wholly owned subsidiaries, each of the financial institutions initially a signatory thereto together with their successors and assignees, and KeyBank National Association, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-33097), filed November 21, 2014.
- 11 Computation of Per Share Earnings from Operations (included in the notes to the audited financial statements contained in this Report).

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| 12         | Statements re: computation of ratios (filed herewith).   |
| 21         | List of Subsidiaries of the Registrant (filed herewith).   |
| 23         | Consent of PricewaterhouseCoopers LLP (filed herewith).  |
| 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). |
| 101.INS*** | XBRL Instance Document   |
| 101.SCH*** | XBRL Taxonomy Extension Schema Document  |
| 101.CAL*** | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.LAB*** | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE*** | XBRL Taxonomy Extension Presentation Linkbase Document   |
| 101.DEF*** | XBRL Definition Linkbase   |

\*\*\* Attached as Exhibit 101 to this Annual Report on Form 10-K are the following materials, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets as of December 31, 2014 and 2013, (ii) the Consolidated Statements of Operations for the years ended December 31, 2014, 2013 and 2012, (iii) the Consolidated Statements of Stockholders' Equity for the years ended December 31, 2014, 2013 and 2012, (iv) the Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012 and (v) the Notes to Consolidated Financial Statements.

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**SIGNATURES**

Pursuant to the requirements of Sections 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: February 18, 2015

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

Date: February 18, 2015

By: /s/ David Gladstone  
David Gladstone  
Chief Executive Officer and

Chairman of the Board of Directors

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 capacities and on the dates indicated.

Date: February 18, 2015

By: /s/ David Gladstone  
David Gladstone

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

Date: February 18, 2015

By: /s/ Terry Lee Brubaker  
Terry Lee Brubaker

Vice Chairman, Chief Operating Officer and  
Director

Date: February 18, 2015

By: /s/ Danielle Jones  
Danielle Jones

Chief Financial Officer

(principal financial and accounting officer)

Date: February 18, 2015

By: /s/ David A.R. Dullum  
David A.R. Dullum

Director

Date: February 18, 2015

By: /s/ Anthony W. Parker

Anthony W. Parker

Director

Date: February 18, 2015

By: /s/ Michela A. English  
Michela A. English

Director

Date: February 18, 2015

By: /s/ Paul Adelgren  
Paul Adelgren

Director

Date: February 18, 2015

By: /s/ John Outland  
John Outland

Director

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Date: February 18, 2015

By: /s/ Walter H. Wilkinson  
Walter H. Wilkinson

Director

Date: February 18, 2015

By: /s/ Caren D. Merrick  
Caren D. Merrick

Director

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