GLADSTONE COMMERCIAL CORP
Form 10-K
February 18, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2013

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	**02-0681276**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
1521 Westbranch Drive, Suite 100	
McLean, Virginia	**22102**
(Address of principal executive offices)	**(Zip Code)**

(703) 287-5800

(Registrant s telephone number, including area code)

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

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

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

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

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 x

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 x 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

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	x
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 Exchange Act). YES ¨ NO x.

The aggregate market value of the voting common stock held by non-affiliates of the Registrant on June 28, 2013, based on the closing price on that date of $18.64 on the NASDAQ Global Select Market, was $252,114,239. For the purposes of calculating this amount only, all directors and executive officers of the Registrant have been treated as affiliates. There were 15,662,414 shares of the Registrant s common stock, $0.001 par value per share, outstanding as of February 18, 2013.

Documents Incorporated by Reference: Portions of the registrant s Proxy Statement, to be filed no later than April 30, 2014, relating to the Registrant s 2014 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, 2013

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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 statement to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Ligation 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 and variations 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:

- our business and financing strategy;
- our ability to implement our business plan;
- pending transactions;
- our projected operating results;
- our ability to obtain future financing arrangements;
- estimates relating to our future distributions;
- our understanding of our competition and our ability to compete effectively;
- market and industry trends;
- interest and insurance rates;

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

- projected capital expenditures; and

- use of the proceeds of our New Line of Credit (as defined herein), mortgage notes payable, 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 to not place undue reliance on forward-looking statements. Except as otherwise may be required by law, we undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or actual operating results. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including, but not limited to:

- 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 risks of changes in 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 with other real estate investment companies;

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

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

changes in our industry or the general economy;

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

changes in governmental regulations, tax rates and similar matters;

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 materially and adversely affect us.

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 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 in the past generally entered into, and intend in the future to enter into, purchase agreements for real estate having triple net leases with terms of approximately 10 to 15 years and built-in rental increases. Under a triple net lease, the tenant is required to pay all operating, maintenance and insurance costs and real estate taxes with respect to the leased property. As of February 18, 2014, we owned a total of 87 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. Administrative services for us are provided by Gladstone Administration, LLC, or our Administrator. Both our Advisor 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 out 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 from time to time when our Adviser determines that doing so would be advantageous to us and our stockholders. We also expect to occasionally make mortgage loans secured by income-producing commercial, industrial or retail real estate, which loans may have some form of equity participation. We currently have no investments in mortgage loans.

We use leverage in order to maximize potential returns to stockholders. We are not limited with respect to the amount of leverage that we may use for the acquisition of any specific property, although we have certain portfolio-level leverage covenants we must comply with under the terms of our unsecured line of credit, or the New 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, they are obtainable and the environment is competitive. The collateralized mortgage backed securities, or CMBS, market has made a comeback, 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 2013 by issuing shares of common stock in three separate follow-on public offerings, issuing shares of our senior common stock and issuing shares under our at-the-market program, or ATM Program, pursuant to an open market sale agreement with Jefferies, LLC, or Jefferies.

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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 the vast majority of our investments will be structured as net leases, but if a net lease would have an adverse impact on a potential tenant, or would otherwise be inappropriate for us, we may structure our investment as 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 for these transactions by purchasing one or more properties from the tenant and by net leasing it to the tenant or its successor in interest. For a discussion of the risks associated with leasing property to leveraged tenants, see *Risk Factors Highly leveraged tenants 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 also own and consider for ownership 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 of a property or would otherwise be inappropriate for us. We anticipate that most of our lending transactions will be loans secured by industrial or commercial property. Our Adviser will attempt to structure mortgage loans in a manner that would provide us with current income substantially similar to that which we could expect to receive had the investment been structured as a net lease transaction.

To the extent that we invest in mortgage loans, we will generally originate those loans. However, we may also purchase mortgage loans from banks, CMBS pools or other lenders if such transactions are consistent with our investment objectives. Our Adviser will service the mortgage loans in our portfolio by monitoring the collection of monthly principal and interest payments on our behalf. We had no mortgage loans outstanding as of December 31, 2013.

Underwriting Criteria, Due Diligence Process and Negotiating Lease Provisions

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

> *Credit Evaluation*. Our Adviser evaluates each potential tenant for its creditworthiness, considering factors such as the rating by a national credit rating agency, if any, management experience, industry position and fundamentals, operating history and capital structure. Currently, 44% 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.

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

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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 becomes bankrupt, 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, for example, operational or financial covenants of the tenant, as well as indemnification of us by the tenant against environmental and other contingent liabilities. We believe that these provisions serve to protect our investments from changes in the operating and financial characteristics of a tenant that may impact its ability to satisfy its obligations to us or that could reduce the value of our properties. 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 all aspects of the structures in order to determine the longevity of each building on the property. This review normally also includes the components of each building, such as the roof, the 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 the value of the real estate. All of our Adviser s due diligence is aimed at arriving at a valuation of the real estate under the assumption that it 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 satisfaction of the debt. We believe that this financing strategy, to the extent available, protects our other assets. However, we can provide no assurance that non-recourse financing will be available on terms acceptable to us, or at all, and there may be circumstances where lenders have recourse to our other assets. To a much lesser extent, we use recourse financing. Of the $422.6 million in long-term mortgages outstanding as of December 31, 2013, 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 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%, any assets or other property;

- 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.

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, 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. 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. 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, including 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 and treasurer, chief compliance officer, internal counsel 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.

Our Adviser maintains an 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 Adviser s investment committee gives us a unique competitive advantage over other REITs because of the substantial experience that the 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 its investment committee to authorize and approve our investments, subject to the terms of the Advisory Agreement. Before we acquire any property, the transaction is reviewed by our

Adviser s investment committee to ensure that, in its view, the proposed transaction satisfies our investment criteria and is within our investment policies. Approval by our Adviser s investment committee is generally the final step in the property acquisition approval process, although the separate approval of our Board of Directors is required in certain circumstances described below. For further detail on this process, please see *Investment Policies - Underwriting Criteria, Due Diligence Process and Negotiating Lease Provisions*.

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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 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).

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 each of the years ended December 31, 2013, 2012 and 2011, tenants paid approximately $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 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 New 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 and treasurer, chief compliance officer, internal counsel and secretary, and their respective staffs. Our allocable portion of expenses is generally derived by multiplying our Administrator s total expenses by the percentage of our total assets at the beginning of each quarter in comparison to the total assets of all companies managed by our Adviser under similar agreements.

Adviser Duties and Authority under the Advisory Agreement

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

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

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

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

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

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

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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 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. 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 $0.3 million and $0.2 million during the years ended December 31, 2013 and 2012, respectively, to the Dealer Manager pursuant to this agreement, which 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.

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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 will 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 0.5% 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 the year ended December 31, 2013 on total mortgages secured of $76.3 million, or 0.18%. The agreement is scheduled to terminate on August 31, 2014, unless renewed or earlier terminated pursuant to the provisions contained therein.

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 2014. 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, 2013, our Adviser and Administrator collectively had 62 full-time employees. A breakdown of these employees is summarized by functional area in the table below:

Number of Individuals	**Functional Area**
10	Executive Management
38	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 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. A request for any of

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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.

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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 the economy

The failure of U.S. lawmakers to reach an agreement on the national debt ceiling could have a material adverse effect on our business, financial condition and results of operations.

In February 2014, the U.S. Congress passed legislation to increase the debt ceiling through March 2015. Congress will need to pass additional legislation prior to March 2015 to further increase the debt ceiling in order for the government to continue to make payments to its creditors. In the event U.S. lawmakers fail to reach a viable agreement on the national debt ceiling, the U.S. could default on its obligations, which could negatively impact the trading market for U.S. government securities. This may, in turn, negatively affect our ability to obtain financing for our investments. As a result, it may materially adversely affect our business, financial condition and results of operations.

While the U.S. has begun to see improving financial indicators since the 2008 recession, recent events have created more uncertainty in the U.S. economy and capital markets. Therefore, we remain cautious about a long-term economic recovery.

Over the last several years, the U.S. capital markets have experienced significant price volatility and liquidity disruptions, which have caused market prices of many stocks and debt securities to fluctuate substantially and the spreads on prospective debt financings to widen considerably. These circumstances have materially impacted liquidity in the financial markets, making terms for certain financings less attractive, and in certain cases have resulted in the lack of availability of certain types of financing. Continued uncertainty in the stock and credit markets may negatively impact our ability to access additional financing at reasonable terms, which may negatively affect our ability to make acquisitions. These disruptions in the financial markets also may have a material adverse effect on the market value of our common and preferred stock and the lease rates we can charge for our properties, as well as other unknown adverse effects on us or the economy in general. In addition, the continued challenging economic conditions could still materially and adversely impact the financial condition of one or more of our tenants and, therefore, could increase the likelihood that a tenant may declare bankruptcy or default upon its payment obligations arising under a related lease.

A further downgrade of the United States credit rating and the ongoing economic crisis in Europe could negatively impact our liquidity, financial condition and earnings.

Recent U.S. debt ceiling and budget deficit concerns, together with signs of deteriorating sovereign debt conditions in Europe, have increased the possibility of additional credit-rating downgrades and economic slowdowns. In August 2011, Standard & Poor s downgraded its long-term sovereign credit rating on the U.S. to AA+ for the first time due to the U.S. Congress inability to reach an effective agreement on the national debt ceiling and a budget in a timely manner. The current U.S. debt ceiling and budget deficit concerns have increased the possibility of the credit-rating agencies further downgrading the U.S. credit rating. On October 15, 2013, Fitch Ratings Service placed the U.S. credit rating on negative watch, warning that a failure by the U.S. Government to honor interest or principal payments on U.S. treasury securities would impact its decision on whether to downgrade the U.S. credit rating. Fitch also stated that the manner and duration of an agreement to raise the debt ceiling and resolve the then existing budget impasse, as well as the perceived risk of such events occurring in the future, would weigh on its ratings.

The impact of any further downgrades to the U.S. government s sovereign credit rating, or its perceived creditworthiness, and deteriorating sovereign debt conditions in Europe, is inherently unpredictable and could adversely affect the U.S. and global financial markets and economic conditions. There can be no assurance that governmental or other measures to aid economic recovery will be effective. 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 the debt markets on favorable terms. In addition, the decreased 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 our business, financial condition and results of operations.

Inflation may adversely affect our financial condition and results of operations.

Although inflation has not materially impacted our results of operations in the past, increased inflation could have a more pronounced negative impact on our results of operations. During times when inflation is greater than increases in rent, as provided for in our leases, rent increases may not keep up with the rate of inflation. Likewise, even though triple net leases reduce our exposure to rising property expenses due to inflation, substantial inflationary pressures and increased costs may have an adverse impact on our tenants if increases in their operating expenses exceed increases in revenue, which may adversely affect the tenants ability to pay rent.

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

On March 23, 2010, the President of the United States signed into law the Patient Protection and Affordable Care Act of 2010 and on March 30, 2010, the President signed into law 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. In January 2014 Moody s Investors Service downgraded its credit rating outlook for U.S. Healthcare Insurers from stable to negative, citing uncertainty stemming from the unstable and evolving regulatory environment. 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 are not yet known. Accordingly, the Acts could adversely affect the cost of providing healthcare coverage generally and could adversely affect the financial and operational performance of our tenants and their results of operations.

Risks related to our financing

Our New 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 New 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, and continued compliance with this covenant may require us to limit our distributions to stockholders. As of December 31, 2013, 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 New 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.

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

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.

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

We intend to acquire additional properties by using our New 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. The market for long-term mortgages has been limited for some time; however, we have recently seen mid-to-long-term (5 to 10 year) mortgages become more obtainable. The CMBS market has made a comeback over the past year, but it is much more conservative than it was prior to the recession and the pricing in the market remains somewhat volatile. Consequently, we are looking 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. As of December 31, 2013, we had obtained approximately $422.6 million in long-term financing, which we have used to acquire additional properties. If we are unable to make our debt payments as required, a lender could foreclose on the property securing its loan. This could cause us to lose part or all of our investment in such property which in turn could cause the value of our securities or the amount of distributions to our stockholders to be reduced.

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

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

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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 New 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.

Risks related to the real estate industry

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

Our investments include net leased industrial, 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. As discussed in *Risks related to the economy* above, the credit markets have tightened resulting in a significant contraction in available liquidity. Accordingly, the credit market constraints and recession may increase the operating expenses of our tenants and decrease their ability to make lease payments, and thereby adversely affect our liquidity, financial condition, results of operations and ability to pay distributions to our stockholders.

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

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

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

We have acquired an interest in certain of our properties by acquiring a leasehold interest in the land underlying the property, and we may acquire additional properties in the future that are subject to similar ground leases. In this situation, we have no economic interest in the land underlying the property and do not control this land. We do not control the underlying land and 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.

Risks related to our tenants, borrowers and properties

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

Some of our tenants and borrowers may have recently been either restructured using leverage, or acquired in a leveraged transaction. Tenants and borrowers that are subject to significant debt obligations may be unable to make their rent or mortgage payments if there are adverse changes to their businesses or because of the impact of the recent recession discussed in *Risks related to the economy*. Tenants that have experienced leveraged restructurings or acquisitions will generally have substantially greater debt and substantially lower net worth than they had prior to the leveraged transaction. In addition, the payment of rent and debt service may reduce the working capital available to leveraged entities and prevent them from devoting the resources necessary to remain competitive in their industries.

In situations where management of the tenant or borrower will change after a transaction, it may be difficult for our Adviser to determine with 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.

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

- the loss of lease or mortgage payments to us;
- an increase in the costs we incur to carry the property occupied by such tenant;
- a reduction in the value of our securities; or
- a decrease in distributions to our stockholders.

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

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

We expect a large portion of our rental income to come from 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, net leases are typically for longer lease terms and, thus, there is an increased risk that contractual rental increases in future years will fail to result in fair market rental rates during those years. As a result, our income and distributions to our stockholders could be lower than they would otherwise be if we did not engage in net leases.

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. In addition, because of the lack of available credit in the current marketplace for small and medium-sized businesses, as discussed in *Risks related to the economy* above, our tenants might not be able to obtain the financing necessary to fund their working capital, which could hinder their ability to make their lease or mortgage payment on a timely basis, or at all.

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

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

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

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

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

We may not have funding for future tenant improvements, which may be required to secure tenants for vacant space.

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

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.

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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, 2013, we owned 87 properties and had 73 tenants in these properties, and our 5 largest tenants accounted for approximately 17.1% 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, 2013, 17.0% of our total rental income was earned from tenants in the telecommunications industry, 12.5% was earned from tenants in the healthcare industry, and 9.4% 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.

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

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

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. Any of these factors could adversely impact our financial condition, results of operations, cash flow or our ability to pay distributions to our stockholders.

Liability for uninsured losses could adversely affect our financial condition.

Losses from disaster-type occurrences (such as wars, 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

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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 contain regulated wetlands that can delay or impede development or require costs to be incurred to mitigate the impact of any disturbance. Absent appropriate permits, we can be held responsible for restoring wetlands and be required to pay fines and penalties.

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

Independent environmental consultants conduct Phase I environmental site assessments on all of our acquisitions. Phase I environmental site assessments are intended to evaluate information regarding the environmental condition of the surveyed property and surrounding properties based generally on visual observations, interviews and certain publicly available databases. These assessments do not typically take into account all environmental issues including, but not limited to, testing of soil or groundwater or the possible presence of asbestos, lead-based paint, radon, wetlands or mold. The results of these assessments are addressed and could result in either a cancellation of the purchase, the requirement of the seller to remediate issues, or additional costs on our part to remediate the issue.

None of the previous site assessments revealed any past or present environmental liability that we believe would be material to us. However, the assessments may have failed to reveal all environmental conditions, liabilities or compliance concerns. Material environmental conditions, liabilities or compliance concerns may have arisen after the assessments were conducted or may arise in the future, and future laws, ordinances or regulations may impose material additional environmental liability. We cannot assure you that costs of future environmental compliance will not affect our ability to make distributions or that such costs or other remedial measures will not be material to us.

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

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

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. Ongoing adverse market and economic conditions and market volatility make it difficult to value our properties. 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.

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

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

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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 employed by our Adviser 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 treasurer, and president, all of our officers and directors are also 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 officers and eight of our nine directors are also 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.

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

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

The Advisory Agreement contemplates a quarterly incentive fee based on our funds from operations. Our Adviser has the ability to issue a full or partial waiver of the incentive fee for current and future periods; however, our Adviser is not required to issue any waiver. Any waiver issued by our Adviser is an unconditional and irrevocable waiver. For the years ended December 31, 2013, 2012 and 2011, an unconditional and irrevocable voluntary waiver was issued by our Adviser for approximately $3.5 million, $2.2 million and $2.1 million, respectively. If our Adviser does not issue this waiver in future quarters, it could negatively impact our earnings and may compromise our ability to maintain our current level of, or increase, distributions to our stockholders, which could have a material adverse impact on the market price of our securities.

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

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

Risks Related to Qualification and Operation as a REIT

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

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

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

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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 dividends paid deduction). To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to 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 dividends to our stockholders in a manner that allows us to meet the 90% distribution requirement and avoid this 4% excise tax, we cannot assure you that we will always be able to do so.

Complying with 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 dividends, gain from the sale or disposition of stock or securities, or any combination of these.

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

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

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

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

The maximum federal income tax rate applicable to income from qualified dividends payable to U.S. stockholders that are individuals, trusts and estates was reduced by legislation to 15% (or 20% for those taxpayers who earn above a certain income threshold). Dividends payable by REITs, however, generally are not eligible for the reduced rates. Although this legislation does not adversely affect the taxation of REITs or dividends payable by REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the shares of REITs, including our stock.

Complying with 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.

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

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

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.

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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.

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.

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

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

Legislative or regulatory action could adversely affect investors.

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

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

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

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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.

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

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

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

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

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.

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Item 2. Properties.

The following table provides certain summary information about our 87, wholly-owned, properties as of December 31, 2013 (dollars in thousands, except per square foot information).

Property	Year Built/ Improvements	Date of Purchase	Rentable Square Feet	Occupancy	Year of Lease Expiration	Total Rental Income for the year ended December 31, 2013 (4)	Total Rental Income per Occupied Square Foot	Encumbrances
208 South Rogers Lane (Raleigh NC)	1997	12/23/2003	58,926	100%	2015	$ 624	$ 10.59	$ 4,856
3874 Highland Park NW (Canton, OH)	1994	1/30/2004	54,018	100%	2024	292	5.41	2,717
260 Springside Drive (Akron, OH) (1)	1968/1999	4/29/2004	83,891	100%	2015	1,027	12.24	6,962
5815 Westpark Drive (Charlotte, NC)	1984/1995	6/30/2004	64,500	100%	2019	1,072	16.62	6,440
171 Great Oak Drive (Canton, NC)	1998	7/6/2004	228,000	100%	2024	606	2.66	3,722
Rt. 219, Tax Parcel No. 33-251-0246, (Crenshaw, PA)	1991	8/5/2004	290,000	100%	2026	788	2.72	5,274
9698 Old US Hwy. 52 (Lexington, NC)	1986	8/5/2004	154,000	100%	2026	395	2.56	2,683
9100 Highway 290 East (Austin, TX)	2001	9/16/2004	51,933	100%	2015	751	14.46	6,500
13 Industrial Park Drive	1995-1999	10/15/2004	223,275	100%	2021	633	2.84	4,969

(Mt. Pocono, PA)								
6550 First Park Ten Boulevard (San Antonio, TX)	1999	2/10/2005	60,245	100%	2021	785	13.03	6,760
4630 Journal Street (Columbus, OH)	1995	2/10/2005	39,000	100%	2015	308	7.90	2,565
199 Sing Sing Road (Big Flats, NY)	2001	4/15/2005	120,000	100%	2023	494	4.12	5,442
2525 North Woodlawn Avenue (Wichita, KS)	2000	5/18/2005	69,287	100%	2017	781	11.27	7,696
725 & 737 Great Southwest Pkwy (Arlington, TX)	1966	5/26/2005	64,000	100%	2018	706	11.03	3,881
4032 Linden Avenue (Dayton, OH)	1956	6/30/2005	59,894	100%	2015	268	4.47	1,914
81 Corbett Way (Eatontown, NJ)	1991	7/7/2005	30,268	100%	2024	537	17.74	4,427
17 & 20 Veronica Avenue (Franklin Township, NJ)	1978	7/11/2005	183,000	100%	2020	988	5.40	6,564
150 Ridgeview Center Drive (Duncan, SC)	1984/2001/2007	7/14/2005	222,670	100%	2020	1,539	6.91	10,592
170 Ridgeview Center Drive (Duncan, SC)	1984/2001/2007	7/14/2005	55,350	100%	2020	383	6.92	2,633
5656 Campus Parkway (Hazelwood, MO)	1977	8/5/2005	51,155	100%	2023	83	3.89[2]	2,320
914 Wohlert Street (Angola, IN)	1982	9/2/2005	52,080	100%	2023	127	2.44	646

800 Growth Parkway (Angola, IN)	1998	9/2/2005	50,000	100%	2023	127	2.54	620
802 East 11th Street (Rock Falls, IL)	1988	9/2/2005	52,000	100%	2023	127	2.44	644
2 Opportunity Way (Newburyport, MA)	1994	10/17/2005	86,308	100%	2015	891	10.32	6,385
255 Spring Street (Clintonville, WI)	1992/2013	10/31/2005	521,400	100%	2028	865	1.66	3,090
5700 Lee Road (Maple Heights, OH)	1974	12/21/2005	347,218	100%	2015	1,275	3.67	9,977

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Item 2. Properties (Continued)

Property	Year Built/ Improvements	Date of Purchase	Rentable Square Feet	Occupancy	Year of Lease Expiration	Total Rental Income for the year ended December 31, 2013 (4)	Total Rental Income per Occupied Square Foot	Encumbrances
7545 Midlothian Turnpike (Richmond, VA)	1972	12/30/2005	42,213	0%	2010	$	$	$ 5,275
3930 Sunforest Court (Toledo, OH)	1979	12/30/2005	23,368	100%	2020	276	11.81	2,798
75 Canal Street (South Hadley, MA)	1978	2/15/2006	150,000	100%	2015	260	1.73	
2101 Fox Drive (Champaign, IL)	1996	2/21/2006	20,400	100%	2024	263	12.89	1,545
2109 Fox Drive (Champaign, IL)	1996	2/21/2006	40,000	100%	2024	517	12.93	3,030
2215 Fox Drive (Champaign, IL)	1996	2/21/2006	25,000	100%	2024	323	12.92	1,894
2301 Fox Drive (Champaign, IL)	1996	2/21/2006	22,862	100%	2024	295	12.90	1,731
2470 Highcrest Road (Roseville, MN)	1964	2/21/2006	359,540	33%	2017	1,196	3.33	17,455
12000 Portland Avenue South (Burnsville, MN)	1984	5/10/2006	114,100	100%	2015	1,235	10.82	11,193
14701 Anthony Avenue (Menomonee Falls, WI)	1986/2000	6/30/2006	125,692	100%	2016	786	6.25	6,823
1025 Birdsong Drive	1997	7/11/2006	12,000	0%	2013	85	7.08	2,000

(Baytown, TX)								
42400 Merrill Road (Sterling Heights, MI)	1979/1989	9/22/2006	532,869	100%	2016	1,167	2.19	
2150, 2200 Pinson Valley Parkway (Birmingham, AL)	1961/1980	9/29/2006	63,514	100%	2016	271	4.27	
2325 West Fairview Avenue (Montgomery, AL)	1962/1989	9/29/2006	29,472	100%	2016	126	4.28	
5221 N Highway 763 (Columbia, MO)	1978	9/29/2006	16,275	100%	2016	69	4.24	
4690 Parkway Drive (Mason, OH)	2002	1/5/2007	60,000	100%	2020	554	9.23	4,346
201 South Rogers Lane (Raleigh, NC)	1994	2/16/2007	115,500	100%	2015	717	6.21	5,249
1110 West Tenkiller (Tulsa, OK) (3)	2004	3/1/2007	238,310	100%	2019	1,566	6.57	8,031
3725 East 10th Court (Hialeah, FL)	1956/1992	3/9/2007	132,337	100%	2027	1,109	8.38	
554 Clark Road (Tewksbury, MA)	1985/1989	5/17/2007	102,200	100%	2017	923	9.03	
5324 Natorp Boulevard (Mason, OH)	2007	7/1/2007	21,264	100%	2027	583	27.42	4,630
7282 Willam Barry Boulevard (Cicero, NY)	2005	9/6/2007	71,880	100%	2020	530	7.37	4,052
1515 Arboretum Drive SE (Grand Rapids, MI)	2001	9/28/2007	63,235	100%	2025	1,088	17.21	5,964
4 Territorial Court (Bollingbrook, IL)	2002	9/28/2007	55,869	100%	2014	619	11.08	

2349 Lawrenceville Highway (Decatur, GA)	1989	12/13/2007	16,740	100%	2031	516	30.82
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

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Item 2. Properties (Continued)

Property	Year Built/ Improvements	Date of Purchase	Rentable Square Feet	Occupancy	Year of Lease Expiration	Total Rental Income for the year ended December 31, 2013 (4)	Total Rental Income per Occupied Square Foot	Encumbrances
311 Phillip Boulevard (Lawrenceville, GA)	2005	12/13/2007	12,412	100%	2031	$ 447	$ 36.01	$
2096 McGee Road (Snellville, GA)	1986	12/13/2007	3,800	100%	2031	116	30.53	
7174 Wheat Street (Covington, GA)	2000	12/13/2007	5,000	100%	2031	153	30.60	
1055 Haw Creek Parkway (Cumming, GA)	2004	12/13/2007	13,919	100%	2026	486	34.92	3,216
1293 Wellbrook Circle (Conyers, GA)	1994	12/13/2007	6,400	100%	2031	195	30.47	
425 Gateway Drive (Reading, PA)	2007	1/29/2008	42,900	100%	2028	717	16.71	4,073
6499 University Avenue NE (Fridley, MN)	1985/2006	2/26/2008	74,160	100%	2020	812	10.95	5,220
7528 Auburn Road (Concord Township, OH)	1957/2008	3/31/2008	273,300	100%	2034	1,727	6.32	
10021 Rodney Street (Pineville, NC)	1985	4/30/2008	74,950	100%	2028	431	5.75	2,368
28305 State Route 7 (Marietta, OH)	1992/2007	8/29/2008	223,458	100%	2028	909	4.07	5,779
400 Highpoint Drive (Chalfont, PA)	1987	8/29/2008	67,200	100%	2016	758	11.28	5,687

1520 Albany Place SE (Orange City, Iowa)	1990	12/15/2010	487,121	100%	2026	1,214	2.49	9,496
2415 Century Place SE (Hickory, North Carolina)	2008	4/4/2011	60,000	100%	2020	936	15.60	6,827
2645 North Airport Plaza Avenue, Lot 2 (Springfield, MO)	2006	6/20/2011	78,421	100%	2021	1,422	18.13	11,164
124 East Hines Road (Boston Heights, OH)	2011	10/20/2011	25,000	100%	2021	377	15.08	2,697
9 Sylvan Way (Parsippany, NJ)	1984	10/28/2011	60,111	100%	2026	1,156	19.23	6,938
495 State Road (Dartmouth, MA) (3) (5)	2011	11/18/2011	16,340	100%	2086	625	38.25	4,155
1955 South National Avenue (Springfield, MO) (3) (6)	2005	12/13/2011	14,560	100%	2080	315	21.63	1,905
810 Parish Street (Pittsburgh, PA)	1968	12/28/2011	26,080	100%	2026	401	15.38	2,829

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Item 2. Properties (Continued)

Property	Year Built/ Improvements	Date of Purchase	Rentable Square Feet	Occupancy	Year of Lease Expiration	Total Rental Income for the year ended December 31, 2013 [4]	Total Rental Income per Occupied Square Foot	Encumbrances
44426 Atwater Place (Ashburn, VA)	2002	1/25/2012	52,130	100%	2027	$ 989	$ 18.97	$ 7,388
14955 6th Street (Ottumwa, IO)	1970	5/30/2012	352,860	100%	2023	693	1.96	4,653
7800 Walton Parkway (New Albany, OH)	2007	6/5/2012	89,000	100%	2023	1,357	15.25	9,361
7200 North Lake Drive (Columbus, GA)	2012	6/21/2012	32,000	100%	2023	656	20.50	4,608
3592 Corporate Drive (Columbus, OH)	1981	6/28/2012	31,293	100%	2022	331	10.58	2,911
1395 University Boulevard (Jupiter, FL)	2011	9/26/2012	60,000	100%	2023	1,372	22.87	10,478
1400 John Burgess Drive (Fort Worth, TX)	2005	11/8/2012	208,234	100%	2026	1,628	7.82	13,864
565 Spears Creek Church Road (Columbia, SC)	2010	11/21/2012	146,483	100%	2022	2,541	17.35	18,525
6725 Delilah Road (Egg Harbor Township, NJ)	1985	3/28/2013	29,257	100%	2023	373	16.74[2]	3,638

17499 Brookwood Parkway (Vance, AL)	2013	5/9/2013	170,000	100%	2023	757	6.90[2]	
3785 Pheasant Ridge Drive NE (Blaine, MN)	2009	5/10/2013	92,275	100%	2020	947	15.98[2]	8,163
717 E. Parmer Lane (Austin, TX)	1999	7/9/2013	320,000	100%	2020	2,299	14.50[2]	35,093
805 Central Expressway South (Allen, TX)	1998	7/10/2013	115,200	100%	2021/2022[7]	685	12.83[2]	8,852
349 Inverness Drive South (Englewood, CO)	2008	12/11/2013	99,797	100%	2021	85	15.00[2]	11,315
43700 Gen-Mar Drive (Novi, MI)	1988	12/27/2013	156,200	100%	2024	9	4.38[2]	4,380
Totals			9,256,779			**$ 59,769**		**$ 421,878**

(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 2013.
(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 26-75.
(6) Tenant has the option to terminate the lease in years 19-62.
(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

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The following table summarizes the lease expirations by year for our properties for leases in place as of December 31, 2013 (dollars in thousands):

Year of Lease Expiration	Square Feet (1)	Number of Expiring Leases	Rental Revenue for the year ended December 31, 2013 (2)	% of Annualized Base Rent
2014	55,869	1	$ 619	1.0%
2015	1,106,770	11	7,356	12.3
2016	835,022	4	3,177	5.3
2017	291,334	3	2,900	4.9
2018	64,000	1	706	1.2
2019	302,810	2	2,638	4.4
2020	1,162,703	9	9,264	15.6
2021+	5,144,365	42	33,024	55.3
Total	8,962,873	73	$ 59,684	100%

(1) Our two fully vacant, and one partially vacant buildings total 293,906 square feet.
(2) Rental revenue for the year ended December 31, 2013 for our property in Baytown, TX, whose lease expired during 2013, was $85.

The following table summarizes the geographic locations of our properties for leases in place as of December 31, 2013 (dollars in thousands):

State	Number of Leases for the year ended December 31, 2013	Rental Revenue for the year ended December 31, 2013	% of Base Rent
Ohio	14	$ 9,284	15.5%
Texas	7	6,939	11.6
North Carolina	7	4,781	8.0
South Carolina	2	4,463	7.5
Minnesota	4	4,190	7.0
All Other States	39	30,112	50.4
Total	73	$ 59,769	100%

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The following table summarizes rental income by tenant industries for the years ended December 31, 2013, 2012 and 2011 (dollars in thousands):

	For the year ended December 31,					
	2013		2012		2011	
Industry Classification	Rental Income	Percentage of Rental Income	Rental Income	Percentage of Rental Income	Rental Income	Percentage of Rental Income
Telecommunications	$ 10,102	17.0%	$ 7,351	14.4%	$ 6,206	14.1%
Healthcare	7,486	12.5	5,228	10.3	4,108	9.4
Automobile	5,589	9.4	1,944	3.8	1,168	2.7
Personal, Food & Miscellaneous Services	5,231	8.8	2,479	4.9	649	1.5
Electronics	4,982	8.3	6,189	12.3	6,046	13.9
Diversified/Conglomerate Manufacturing	3,665	6.1	3,664	7.2	3,664	8.4
Chemicals, Plastics & Rubber	3,236	5.4	3,153	6.2	3,146	7.2
Beverage, Food & Tobacco	3,007	5.0	2,844	5.6	2,271	5.2
Personal & Non-Durable Consumer Products	2,583	4.3	2,507	4.9	2,316	5.3
Machinery	2,265	3.8	2,259	4.4	2,256	5.2
Containers, Packaging & Glass	2,171	3.6	2,344	4.6	2,339	5.4
Buildings and Real Estate	2,160	3.6	2,144	4.2	2,120	4.9
Printing & Publishing	1,848	3.1	1,894	3.7	1,979	4.5
Oil & Gas	1,275	2.1	1,271	2.5	1,271	2.9
Diversified/Conglomerate Services	1,244	2.1	1,244	2.4	1,001	2.3
Banking	1,156	1.9	1,149	2.3	204	0.5
Education	656	1.1	2,138	4.2	1,775	4.1
Childcare	583	1.0	583	1.1	583	1.3
Home & Office Furnishings	530	0.9	530	1.0	530	1.2
	$ 59,769	100.0%	$ 50,915	100.0%	$ 43,632	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.

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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, 2013 and 2012. Distributions to common stockholders are declared quarterly and paid monthly. Amounts presented represent the cumulative amount of the monthly common stock distributions declared during such quarter.

	Price Range		Distributions Per Common Share
	High	Low	
2012			
3/31/2012	$ 18.92	$ 16.80	$ 0.375
6/30/2012	17.66	15.56	0.375
9/30/2012	19.47	16.52	0.375
12/31/2012	18.93	16.15	0.375
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

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 as to whether to authorize and pay distributions on shares of our common stock in the future, as well as the timing, amount and composition of any such future distributions, will be at the sole and absolute discretion of our Board of Directors in light of conditions then existing, including our earnings, 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, less the sum of certain non-cash items.

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

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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.

A covenant in the agreement governing our New 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 New Line of Credit, including the financial and operating covenants required for us to access this source of financing, see *Risk Factors Our New 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, 2014, there were 13,267 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 Company s senior common stock is not traded on any exchange or automated quotation system.

As of February 4, 2014, there were 168 beneficial owners of our senior common stock.

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Item 6. Selected Financial Data.

The following selected financial data for the fiscal years ended December 31, 2013, 2012, 2011, 2010 and 2009 is derived from our audited consolidated financial statements. Certain amounts from prior years financial statements have been reclassified to discontinued operations and these reclassifications had no effect on previously reported net income or stockholders equity. The data should be read in conjunction with our consolidated financial statements and notes thereto, included elsewhere in this report, and *Management s Discussion and Analysis of Financial Condition and Results of Operations* included in Item 7 of this report.

	For the year ended December 31, (Dollars in Thousands, Except Per Share Amounts)				
	2013	2012	2011	2010	2009
Operating Data:					
Total operating revenue	$ 61,343	$ 51,270	$ 43,976	$ 41,928	$ 42,609
Total operating expenses	(32,823)	(24,895)	(21,270)	(23,414)	(20,541)
Other expense	(26,993)	(22,614)	(16,992)	(13,586)	(17,668)
Income from continuing operations	1,527	3,761	5,714	4,928	4,400
Discontinued operations					203
Net income	$ 1,527	$ 3,761	$ 5,714	$ 4,928	$ 4,603
Dividends attributable to preferred stock	(4,094)	(4,093)	(4,094)	(4,094)	(4,094)
Dividends attributable to senior common stock	(300)	(113)	(62)	(20)	
Net (loss) income available to common stockholders	$ (2,867)	$ (445)	$ 1,558	$ 814	$ 509
Share and Per Share Data:					
(Loss) earnings per weighted average common share - basic & diluted					
(Loss) income from continuing operations (net of dividends attributable to preferred stock)	$ (0.22)	$ (0.04)	$ 0.15	$ 0.09	$ 0.04
Discontinued operations					0.02
Net (loss) income available to common stockholders	$ (0.22)	$ (0.04)	$ 0.15	$ 0.09	$ 0.06
Weighted average common shares outstanding-basic	13,164,244	10,953,325	10,236,859	8,576,303	8,563,264
Weighted average common shares outstanding-diluted	13,164,244	10,953,325	10,288,711	8,601,153	8,563,264
Cash dividends declared per common share	$ 1.50	$ 1.50	$ 1.50	$ 1.50	$ 1.50

Supplemental Data:										
Net (loss) income available to common stockholders	$	(2,867)	$	(445)	$	1,558	$	814	$	509
Real estate depreciation and amortization, including discontinued operations		22,827		16,831		14,149		13,264		13,172
Less: Gain on sale of real estate, net of taxes paid										(160)
Funds from operations available to common stockholders [(1)]	$	19,960	$	16,386	$	15,707	$	14,078	$	13,521
Balance Sheet Data:										
Real estate, before accumulated depreciation	$	642,353	$	533,753	$	442,521	$	401,017	$	390,754
Total assets		690,525		564,779		453,147		410,609		416,865
Mortgage notes payable, term loan, term preferred stock and borrowings under the line of credit		485,502		422,685		304,050		286,595		285,962
Total stockholders equity		183,146		122,365		135,314		111,375		118,451
Total common shares outstanding		15,662,414		11,083,584		10,945,379		8,724,613		8,563,264

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

FFO available to common stockholders is FFO adjusted to subtract preferred share and senior common share distributions. We believe that net (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, is calculated as FFO available to common stockholders divided by the weighted average common shares outstanding. Diluted funds from operations per share, or Diluted FFO per share, is calculated as FFO available to common stockholders, adjusted as applicable for the assumed issuance of additional shares of our convertible senior common stock, divided by the weighted average common shares outstanding adjusted for additional shares of common stock, related to our convertible senior common stock, that would have been

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outstanding if dilutive potential shares of common stock had been issued. 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, since most REITs provide FFO available to common stockholders, Basic FFO and Diluted FFO per share information to the investment community, we believe these are useful supplemental measures for comparing us to other REITs. We believe that net (loss) 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, 2013, 2012, 2011, 2010 and 2009 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, (Dollars in Thousands, Except Per Share Amounts)				
	2013	2012	2011	2010	2009
Net income	$ 1,527	$ 3,761	$ 5,714	$ 4,928	$ 4,603
Less: Distributions attributable to preferred and senior common stock	(4,394)	(4,206)	(4,156)	(4,114)	(4,094)
Net (loss) income available to common stockholders	$ (2,867)	$ (445)	$ 1,558	$ 814	$ 509
Add: Real estate depreciation and amortization	22,827	16,831	14,149	13,264	13,172
Less: Gain on sale of real estate					(160)
FFO available to common stockholders	$ 19,960	$ 16,386	$ 15,707	$ 14,078	$ 13,521
Weighted average common shares outstanding - basic	13,164,244	10,953,325	10,236,859	8,576,303	8,563,264
Weighted average common shares outstanding - diluted	13,402,370	11,075,216	10,288,711	8,601,153	8,563,264
Basic FFO per weighted average share of common stock	$ 1.52	$ 1.50	$ 1.53	$ 1.64	$ 1.58
Diluted FFO per weighted average share of common stock	$ 1.49	$ 1.48	$ 1.53	$ 1.64	$ 1.58
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 87 properties totaling 9.3 million square feet, which have a total gross and net carrying value, including intangible assets, of $756.9 million and $640.7 million, respectively. We do not currently have any mortgage loan receivables outstanding.

Business Environment

The United States, or U.S., has been seeing long-term signs of recovery as the unemployment rate continues to decline, housing starts and building permits have increased, and prices for single-family homes increased across 20 U.S. cities because of a dwindling surplus in the housing market. However, various signs of weakness are still present in the U.S economy. 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. Although interest rates have risen significantly since the beginning of the year, they still remain near their historic lows. This continued low interest rate environment is leading to increasing competition for new acquisitions and cap rate compression. However; recent U.S. budget deficit concerns and the budget impasse that resulted in the partial shutdown of the U.S. government in October 2013, have increased the possibility of credit-rating downgrades of the U.S. and economic slowdowns. The continued uncertainty surrounding the outcome of the U.S. government to raise the federal debt ceiling could cause the ratings agencies to lower the long-term sovereign credit rating on the U.S. again. The sovereign credit rating was previously lowered from AAA to AA+ by Standard and Poor s in August 2011. The impact of this or any further downgrades to the U.S. government s sovereign credit rating, or its perceived creditworthiness, is inherently unpredictable and could adversely affect the U.S. and global financial markets and economic conditions. There can be no assurance that governmental or other measures to aid economic recovery will be effective. 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 increasing our funds from operations, or FFO, by re-leasing vacant space in our portfolio and acquiring additional properties. As of December 31, 2013, we had two fully vacant buildings and one partially vacant building. Our fully vacant buildings are located in Baytown, Texas and Richmond, Virginia. Our building located in Roseville, Minnesota remains partially vacant. The leases on these three vacancies comprised 3.2% of our total square footage as of December 31, 2013 and the annual carrying costs are approximately $1.1 million. We continue to actively seek new tenants for our Richmond, Virginia, Baytown, Texas and Roseville, Minnesota buildings.

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 New Line of Credit. The market for long-term mortgages continues to improve and long-term mortgages have become more obtainable. The collateralized mortgage backed securities, or CMBS, market has made a comeback, 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. 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 2013 by issuing shares of common stock in three separate follow-on public offerings, issuing shares of our senior common stock and issuing shares of common stock under our at-the-market program, or ATM Program, pursuant to an open market sale agreement with Jefferies, LLC, or Jefferies, discussed in more detail below.

Recent Developments

2013 Investment Activities

The following is a summary of our recent acquisitions:

Egg Harbor Township, New Jersey: On March 28, 2013, we acquired a 29,257 square foot office building located in Egg Harbor Township, New Jersey for $5.7 million, excluding related acquisition expenses of $0.15 million. We funded this acquisition with existing cash on hand and the issuance of $3.7 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 period of 5 years. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of $0.5 million.

Clintonville, Wisconsin: On April 11, 2013, we funded a $3.3 million, 102,400 square foot expansion of our property located in Clintonville, Wisconsin. In connection with the expansion of the property, we executed a lease amendment to extend the lease for an additional eight years, through October 2028. The lease was originally set to expire in October 2020. The lease was also amended to provide for an increase to the rental income over the life of the lease, with annualized straight line rents of approximately $1.0 million, up from $0.6 million today.

Vance, Alabama: On May 9, 2013, we acquired a 170,000 square foot industrial building located in Vance, Alabama for $13.4 million, excluding related acquisition expenses of $0.19 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 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 $1.2 million.

Blaine, Minnesota: On May 10, 2013, we acquired a 92,275 square foot office building located in Blaine, Minnesota for $14.4 million, excluding related acquisition expenses of $0.08 million. We funded this acquisition with existing cash on hand. The tenant has seven years remaining on the lease and has two options to renew the lease for additional periods of five-years each. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of $1.5 million.

Austin, Texas: On July 9, 2013, we acquired a 320,000 square foot office building located in Austin, Texas for $57.0 million, excluding related acquisition expenses of $0.16 million. We funded this acquisition with cash on hand and the issuance of $35.3 million of mortgage debt on the property. The tenant has seven years remaining on the lease and has three options to renew the lease for additional periods of three years each. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of $4.7 million.

Allen, Texas: On July 10, 2013, we acquired an 115,200 square foot office building located in Allen, Texas for $15.2 million, excluding related acquisition expenses of $0.08 million. We funded this acquisition with existing cash on hand and the issuance of $8.9 million of mortgage debt on the property. There are two tenants in this property, the largest of which occupies 73% of the space and has nine years remaining on the lease and has two options to renew the lease for additional periods of five years each. The other tenant has eight years remaining on the lease and also has two options to renew the lease for additional periods of five years each. These two leases provide for prescribed rent escalations over the life of the leases, with annualized straight line rents of $1.5 million.

Englewood, Colorado: On December 11, 2013, we acquired a 99,797 square foot office building located in Englewood, Colorado for $18.3 million, excluding related acquisition expenses of $0.07 million. We funded this acquisition with existing cash on hand, and subsequently closed on $11.3 million of mortgage debt on the property. The tenant has eight years remaining on the lease and has two options to renew the lease for additional periods of five years each. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of $1.5 million.

Novi, Michigan: On December 27, 2013, we acquired an 156,200 square foot office building located in Novi, Michigan for $7.3 million, excluding related acquisition expenses of $0.04 million. We funded this acquisition with existing cash on hand, and $4.4 million of mortgage debt on the property. The tenant has 10 years remaining on the lease 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 rents of $0.7 million.

2013 Financing Activities

The following is a summary of our recent financings:

Citigroup: On March 28, 2013, through a wholly-owned subsidiary, we borrowed $3.7 million pursuant to a long-term note payable from Citigroup Global Markets Realty Corp., which is collateralized by a security interest in one of our properties. The note accrues interest at a fixed rate of 4.16% per year and we may not repay this note prior to the last two months of the term, or we would be subject to a prepayment penalty. The note has a maturity date of April 6, 2023. We used the proceeds from the note to acquire the property in Egg Harbor Township, New Jersey on the same date.

Prudential: On July 3, 2013, through a wholly-owned subsidiary, we borrowed $8.2 million pursuant to a long-term note payable from Prudential Mortgage Capital Company, LLC, which is collateralized by a security interest in one of our properties. The note accrues interest at a fixed rate of 5.00% 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 August 1, 2023. We used the proceeds from the note to acquire properties.

Cantor Commercial Real Estate: On July 9, 2013, through a wholly-owned subsidiary, we borrowed $35.3 million pursuant to a long-term note payable from Cantor Commercial Real Estate Lending, L.P., which is collateralized by a security interest in one of our properties. The note accrues interest at a fixed rate of 4.81% 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 August 6, 2023. We used the proceeds from the note to acquire the property in Austin, Texas on the same date.

Synovus Bank: On July 10, 2013, through a wholly-owned subsidiary, we borrowed $8.9 million pursuant to a long-term note payable from Synovus Bank, which is collateralized by a security interest in one of our properties. The note accrues interest at a fixed rate of 4.20% per year and we may prepay this note prior to maturity without penalty. The note has a maturity date of August 1, 2023. We used the proceeds from the note to acquire the property in Allen, Texas on the same date.

KeyBank Line of Credit: On August 7, 2013, we procured a new $60.0 million senior unsecured revolving credit facility, or the New Line of Credit, with Keybank National Association serving as a

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revolving lender, a letter of credit issuer and an administrative agent, and Citizens Bank of Pennsylvania as an additional lender. This New Line of Credit has an initial maturity of August 2016, with a one-year extension option contingent upon an extension fee equal to 25 basis points on the initial maturity date, and certain other customary conditions. The interest rate per annum is equal to the London Interbank Offered Rate, or LIBOR, plus an applicable margin of up to 3.25%, depending upon our leverage.

Wells Fargo: On November 26, 2013, through a wholly-owned subsidiary, we refinanced our mortgage at our Champaign, Illinois property that was originally set to mature on December 1, 2013. We borrowed $8.2 million pursuant to a long-term note payable from Wells Fargo. The new loan is variable rate, in which the interest rate resets monthly and is calculated as the one month London Interbank Offered Rate, or LIBOR, plus a margin of 2.15%. The LIBOR rate is subject to a floor of 0.5% per annum, and minimum interest on this note is 2.65%. The new note has a maturity date of December 1, 2016, with four, one-year extension options at the behest of the borrower. We simultaneously entered into an interest rate cap with Wells Fargo to hedge against the variability of the LIBOR rate, at a cost of approximately $0.03 million through December 1, 2016. We will receive payments from Wells Fargo if the one month LIBOR rate increases above 3.00%, to cap our interest costs at the all in 5.15% interest rate.

Guggenheim Investments: On December 18, 2013, through a wholly-owned subsidiary, we borrowed $11.3 million pursuant to a long-term note payable from Guggenheim Investments, which is collateralized by a security interest in one of our properties. The note accrues interest at a fixed rate of 4.74% per year. The note has a maturity date of January 6, 2039, but is subject to hyper-amortization if the note is not repaid on January 6, 2021. We used the proceeds to repay our line of credit.

KeyBank: On December 27, 2013, through a wholly-owned subsidiary, we borrowed $4.4 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 5.28% 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 January 1, 2024. We used the proceeds from the note to acquire the property in Novi, Michigan on the same date.

2013 Leasing Activities

The following is a summary of our recent leasing activity:

Champaign, Illinois: On January 14, 2013, we extended the lease with the tenant occupying our property located in Champaign, Illinois. The lease covering this property was extended for an additional 11 years, through December 2024. The lease was originally set to expire in December 2013. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately $1.4 million. In connection with the extension of the lease and the modification of certain terms under the lease, we paid $0.4 million in leasing commissions.

Canton, Ohio: On April 10, 2013, we extended the lease with the tenant occupying our property located in Canton, Ohio. The lease covering this property was extended for an additional 10 years, through January 2024. The lease was originally set to expire in January 2014. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately $0.3 million. In connection with the extension of the lease and the modification of certain terms under the lease, we provided a tenant allowance of $0.5 million.

Dayton, Ohio: On May 14, 2013, our tenant occupying our Dayton, Ohio property notified us of their intention to exercise their early termination option. The lease requires the tenant to continue to pay monthly rent through the effective termination date of June 30, 2015.

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Hazelwood, Missouri: On July 17, 2013, we executed a revised lease with a tenant to occupy our previously vacant property located in Hazelwood, Missouri. The lease commences on August 1, 2013 and expires in May 2023. The tenant has two options to purchase the property: one in March 2017 and the other in May 2023. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately $0.2 million. In connection with the extension of the lease and the modification of certain terms under the lease, we paid $0.1 million in leasing commissions and $0.3 million in tenant improvements.

South Hadley, Massachusetts: On August 7, 2013, we extended the lease with the tenant occupying our property located in South Hadley, Massachusetts for an additional year, through January 2015. The lease was originally set to expire in January 2014. The lease provides a scheduled rent increase over the previous lease, with annualized straight line rents of approximately $0.3 million. In connection with the extension of the lease and the modification of certain terms under the lease, we paid $3,400 in leasing commissions.

Lexington, North Carolina: On August 15, 2013, we extended the lease with the tenant occupying our property located in Lexington, North Carolina. The lease covering this property was extended for an additional 12 years, through April 2026. The lease was originally set to expire in April 2014. The lease provides for prescribed rent escalations over the life of the lease, with annualized straight line rents of approximately $0.4 million. In connection with the extension of the lease and the modification of certain terms under the lease, we provided a tenant allowance of $0.05 million, and we paid $0.2 million in leasing commissions.

Crenshaw, Pennsylvania: On August 15, 2013, we extended the lease with the tenant occupying our property located in Crenshaw, Pennsylvania. The lease covering this property was extended for an additional 12 years, through April 2026. The lease was originally set to expire in April 2014. 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 the modification of certain terms under the lease, we provided a tenant allowance of $0.08 million, and we paid $0.4 million in leasing commissions.

Canton, North Carolina: On November 11, 2013, we amended the lease with the tenant occupying our property located in Canton, North Carolina. The amended lease provided that we construct an expansion to the premises of approximately 150,000 rentable square feet. The term of the lease will be extended so that after substantial completion of the expansion, the term remaining under the lease is 20 years. The lease was originally set to expire in July 2024. During the extended term of the lease, rent shall be equal to our incurred construction costs times 9.25% per annum, and subject to a 2% rental increase per year.

2013 Equity Activities

The equity issuances summarized below were issued under our universal shelf registration statements, (File No. 333-169290 and File No. 333-190931) that were effective and on file with the Securities and Exchange Commission at the time of the respective issuance.

Common Equity: During the year ended December 31, 2013, we completed three separate public offerings for a total issuance of 4,146,922 shares of our common stock. We issued 1,265,000 shares of common stock in the first offering, which closed on April 29, 2013, at a public offering price of $18.90 per share. Gross proceeds of this offering totaled $23.9 million and net proceeds, after deducting offering expenses and underwriter discounts, were $22.6 million. We issued 1,478,000 shares of common stock in the second offering, which closed on June 24, 2013, with a partial exercise of the over-allotment option closing on July 11, 2013, at a public offering price of $18.82 per share. Gross proceeds of this offering totaled $27.8 million and net proceeds, after deducting offering expenses and underwriter discounts, were $26.3 million. We issued 1,403,922 shares of common stock in the third offering, which closed on

November 25, 2013, with a partial exercise of

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the over-allotment option closing on December 26, 2013, at a public offering price of $18.15 per share. Gross proceeds of this offering totaled $25.5 million and net proceeds, after deducting offering expenses and underwriter discounts, were $24.2 million. Proceeds from these offerings were used to acquire real estate and for general corporate purposes.

ATM Program: During the year ended December 31, 2013, we raised approximately $7.7 million in net proceeds under our ATM Program with Jefferies. Proceeds from this offering were used to acquire real estate and for general corporate purposes. Under this agreement we may, from time to time, offer to sell shares of our common stock with an aggregate sales price of up to $25.0 million on the open market through Jefferies, as agent, or to Jefferies, as principal, based upon our instructions (including any price, time or size limits or other customary parameters or conditions that we may impose). Sales of shares of our common stock through Jefferies will be executed by means of ordinary brokers transactions on the NASDAQ Global Select Market, or the NASDAQ, or otherwise at market prices, in privately negotiated transactions, crosses or block transactions, as may be agreed between us and Jefferies, including a combination of any of these transactions.

Senior Common Equity: During the year ended December 31, 2013, we sold 189,241, shares of our senior common stock at $15.00 per share in an ongoing best-efforts public offering and issued 8,443 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 $2.6 million. We can issue up to 3,000,000 shares of senior common stock and the offering will continue until the earlier of March 28, 2015 or the date on which a total of 3,000,000 shares of senior common stock are sold. Proceeds from this offering were used to acquire real estate and for general corporate purposes.

Diversity of Our Portfolio

Gladstone Management Corporation, or our Adviser, seeks to diversify our portfolio to avoid dependence on any one particular tenant, industry or geographic market. By diversifying our portfolio, our Adviser intends to reduce the adverse effect on our portfolio of a single under-performing investment or a downturn in any particular industry or geographic market. The table below reflects the breakdown of our total rental income by tenant industry classification for the years ended December 31, 2013, 2012 and 2011, respectively (dollars in thousands):

	For the year ended December 31,					
	2013		2012		2011	
Industry Classification	Rental Income	Percentage of Rental Income	Rental Income	Percentage of Rental Income	Rental Income	Percentage of Rental Income
Telecommunications	$ 10,102	17.0%	$ 7,351	14.4%	$ 6,206	14.1%
Healthcare	7,486	12.5	5,228	10.3	4,108	9.4
Automobile	5,589	9.4	1,944	3.8	1,168	2.7
Personal, Food & Miscellaneous Services	5,231	8.8	2,479	4.9	649	1.5
Electronics	4,982	8.3	6,189	12.3	6,046	13.9
Diversified/Conglomerate Manufacturing	3,665	6.1	3,664	7.2	3,664	8.4
Chemicals, Plastics & Rubber	3,236	5.4	3,153	6.2	3,146	7.2
Beverage, Food & Tobacco	3,007	5.0	2,844	5.6	2,271	5.2
	2,583	4.3	2,507	4.9	2,316	5.3

Personal & Non-Durable Consumer Products						
Machinery	2,265	3.8	2,259	4.4	2,256	5.2
Containers, Packaging & Glass	2,171	3.6	2,344	4.6	2,339	5.4
Buildings and Real Estate	2,160	3.6	2,144	4.2	2,120	4.9
Printing & Publishing	1,848	3.1	1,894	3.7	1,979	4.5
Oil & Gas	1,275	2.1	1,271	2.5	1,271	2.9
Diversified/Conglomerate Services	1,244	2.1	1,244	2.4	1,001	2.3
Banking	1,156	1.9	1,149	2.3	204	0.5
Education	656	1.1	2,138	4.2	1,775	4.1
Childcare	583	1.0	583	1.1	583	1.3
Home & Office Furnishings	530	0.9	530	1.0	530	1.2
	$ 59,769	100.0%	$ 50,915	100.0%	$ 43,632	100.0%

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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. Gladstone Administration, LLC, or our Administrator, employs our chief financial officer and treasurer, chief compliance officer, internal counsel and secretary and their respective staffs. Mr. Gladstone is also the chairman and chief executive officer of our Administrator. Terry Lee Brubaker is also 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, agricultural real estate company. With the exception of Ms. Danielle Jones, our chief financial officer and treasurer, 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, 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.

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 each of the years ended December 31, 2013, 2012 and 2011, tenants paid approximately $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)

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 New 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, 2013, 2012 and 2011, 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 and treasurer, chief compliance officer, internal counsel and secretary, and their respective staffs. Our allocable portion of expenses is generally derived by multiplying our Administrator s total expenses by the percentage of our total assets at the beginning of each quarter in comparison to the total assets of all companies managed by our Adviser under similar agreements.

Critical Accounting Policies

The preparation of our financial statements in accordance with Generally Accepted Accounting Principles in the 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 polices 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, 2013.

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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 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

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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, 2013 for any impairment indicators and performed an impairment analysis on those select properties that had an indication of impairment. We concluded that none of our properties were impaired as of December 31, 2013; however, we determined that our properties located in South Hadley, Massachusetts and Roseville, Minnesota are at risk to become impaired in the future. We recently extended the lease on the property in South Hadley Massachusetts for one year, and it now expires in January 2015. There is a possibility we may have to impair this property in 2014 if we do not negotiate another lease extension on this building or find a replacement tenant.

The current tenant in our property located in Roseville, Minnesota downsized on January 1, 2013. We are currently working to re-tenant the remainder of this building; however, if we do not secure a tenant in the near term there is a possibility we may have to impair this property in 2014.

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

Results of Operations

The weighted-average yield on our total portfolio, which was 8.9% as of December 31, 2013, 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. The weighted-average yield does not account for the interest expense incurred on the mortgages placed on our properties.

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

	For the year ended December 31,			
	2013	2012	$ Change	% Change
Operating revenues				
Rental income	$ 59,769	$ 50,915	$ 8,854	17%
Tenant recovery revenue	1,574	355	1,219	343%
Total operating revenues	61,343	51,270	10,073	20%
Operating expenses				
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%

Total operating expenses before credit to incentive fee	36,280	27,116	9,164	34%
Credit to incentive fee	(3,457)	(2,221)	(1,236)	56%
Total operating expenses	32,823	24,895	7,928	32%
Other income (expense)				
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%

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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.

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 consists 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 dividends 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.

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.

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A comparison of our operating results for the years ended December 31, 2012 and 2011 is below (dollars in thousands, except per share amounts):

	For the year ended December 31,			
	2012	2011	$ Change	% Change
Operating revenues				
Rental income	$ 50,915	$ 43,632	$ 7,283	17%
Tenant recovery revenue	355	344	11	3%
Total operating revenues	51,270	43,976	7,294	17%
Operating expenses				
Depreciation and amortization	16,831	14,149	2,682	19%
Property operating expenses	1,588	986	602	61%
Acquisition related expenses	949	700	249	36%
Base management fee	1,467	1,629	(162)	10%
Incentive fee	3,569	3,398	171	5%
Administration fee	1,118	1,024	94	9%
General and administrative	1,594	1,497	97	6%
Total operating expenses before credit from Adviser	27,116	23,383	3,733	16%
Credit to incentive fee	(2,221)	(2,113)	(108)	5%
Total operating expenses	24,895	21,270	3,625	17%
Other income (expense)				
Interest expense	(20,226)	(17,076)	(3,150)	18%
Distributions attributable to mandatorily redeemable preferred stock	(2,515)		(2,515)	NM
Other income	127	84	43	51%
Total other expense	(22,614)	(16,992)	(5,622)	33%
Net income	3,761	5,714	(1,953)	34%
Distributions attributable to preferred stock	(4,093)	(4,094)	1	0%
Distributions attributable to senior common stock	(113)	(62)	(51)	82%
Net (loss) income available to common stockholders	$ (445)	$ 1,558	$ (2,003)	129%

Net (loss) income available to common stockholders per weighted average share of common stock - diluted	$ (0.04)	$ 0.15	$ (0.19)	127%
FFO available to common stockholders	$ 16,386	$ 15,707	$ 679	4%
Diluted FFO per weighted average share of common stock	$ 1.48	$ 1.53	$ (0.05)	4%

NM = Not meaningful

Operating Revenues

Rental income increased for the year ended December 31, 2012, as compared to the year ended December 31, 2011, because of the eight properties acquired during 2012.

Tenant recovery revenue increased for the year ended December 31, 2012, as compared to the year ended December 31, 2011. There was an increase in insurance premiums from 2011, resulting in increased reimbursements from our tenants coupled with an increase in insurance reimbursements we received from certain of our tenants at our properties acquired during 2012.

Operating Expenses

Depreciation and amortization expenses increased for the year ended December 31, 2012, as compared to the year ended December 31, 2011, because of the eight properties acquired during 2012 and a full year of depreciation for properties acquired in 2011.

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, 2012, as compared to the year ended December 31, 2011, primarily because of ground lease payments we are responsible for paying at two of our properties acquired in the fourth quarter of 2011, coupled with an increase in overhead expenses and franchise taxes paid at certain of our vacant properties.

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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 expenses increased for the year ended December 31, 2012, as compared to the year ended December 31, 2011, as a result of costs incurred related to the eight properties acquired during 2012 coupled with costs incurred for other potential acquisitions, partially offset by an out of period adjustment of $250,000 recorded during the year ended December 31, 2011, related to the acquisition of the property in Orange City, Iowa in December 2010.

The base management fee decreased for the year ended December 31, 2012, as compared to the year ended December 31, 2011, due to a decrease 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, 2012, as compared to the year ended December 31, 2011, 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 eight acquisitions made in 2012, which was partially offset by an increase in property operating, due diligence and interest expenses during the year ended December 31, 2012, as compared to the year ended December 31, 2011.

The incentive fee credit increased slightly for the year ended December 31, 2012, as compared to the year ended December 31, 2011, because of the increase in the amount of common dividends paid for 2012, which resulted in a larger portion of the incentive fee which was credited. 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, 2012, as compared to the year ended December 31, 2011, primarily as a result of an increase in the amount of the total expenses our Administrator incurred during 2012. 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, 2012, as compared to the year ended December 31, 2011, primarily due to increase in legal fees incurred at certain of our properties for various projects at those properties coupled with an increase in stockholder related expenses.

Other Income and Expense

Interest expense increased for the year ended December 31, 2012, as compared to the year ended December 31, 2011. This increase was primarily a result of interest on the $124.4 million of mortgage debt assumed and issued during 2012, partially offset by reduced interest expense on our long-term financings from amortizing and balloon principal payments made during 2012.

Distributions on our mandatorily redeemable preferred stock for the year ended December 31, 2012, are from the public offering of 1,540,000 shares of our 7.125% Series C Term Preferred Stock completed in February 2012. There were no distributions on our mandatorily redeemable preferred stock for the year ended December 31, 2011 as there was none outstanding.

Other income increased during the year ended December 31, 2012, as compared to the year ended December 31, 2011, because of an easement payment and a bankruptcy settlement from a former tenant received in 2012 related to our property located in Sterling Heights, Michigan. This was partially offset by lower interest income on employee loans during the year ended December 31, 2012, as compared to the year ended December 31, 2011 due to principal repayments made by employees of our Adviser during 2012.

Net (Loss) Income Available to Common Stockholders

Net (loss) income available to common stockholders decreased for the year ended December 31, 2012, as compared to the year ended December 31, 2011, primarily because of increased interest expense, increased 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 eight properties acquired in 2012.

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Liquidity and Capital Resources

Overview

Our sources of liquidity include cash flows from operations, cash and cash equivalents, borrowings under our New Line of Credit, obtaining mortgages on our unencumbered properties and issuing additional equity securities. Our available liquidity at December 31, 2013, was $25.6 million, including $8.5 million in cash and cash equivalents and an available borrowing capacity of $17.1 million under our New Line of Credit.

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 New Line of Credit. Accordingly, to ensure that we are able to effectively execute our business strategy, we routinely review our liquidity requirements and continually evaluate all potential sources of liquidity. Our short-term liquidity needs include proceeds necessary to fund our distributions to stockholders, pay the debt service costs on our existing long-term mortgages and on borrowings under our New 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 New 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 2013, we raised $77.2 million of common equity in three follow-on public offerings, or $73.1 million in net proceeds, at a weighted average share price of $18.62. We also raised $7.8 million of common equity under our ATM Program, or $7.7 million in net proceeds, at an average share price of $18.72. Furthermore, we raised $2.6 million in net proceeds of senior common equity. We used these proceeds to acquire additional real estate and repay a portion of the outstanding balance of the New Line of Credit, with the remainder used for general corporate and working capital needs.

As of today, we have the ability to raise up to $273.6 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 $273.6 million of available capacity under our Universal Shelf, $11.0 million of common stock is reserved for additional sales under our ATM Program and $48.2 million is reserved for sales of our senior common stock.

Debt Capital

As of December 31, 2013, we had mortgage notes payable in the aggregate principal amount of $421.9 million, collateralized by a total of 70 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, 2013 was 5.4%.

The CMBS market has returned; 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 CMBS.

We have mortgage debt in the aggregate principal amount of $24.8 million payable during 2014 and $42.4 million payable during 2015. The 2014 principal amounts payable include both amortizing principal payments and a balloon principal payment due in June 2014 of $17.5 million. We are currently in conversations with the lender in advance of the maturity in June 2014. We intend to pay the 2014 debt amortization payments from operating cash flow and borrowings under our New Line of Credit.

Operating Activities

Net cash provided by operating activities during the year ended December 31, 2013, was $19.9 million, as compared to net cash provided by operating activities of $23.4 million for the year ended December 31, 2012. This decrease was primarily a result of a decrease in our account payables coupled with the loss of rental income from vacancies in our portfolio, partially offset by an increase in rental income received from the properties acquired in 2013. 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 New 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, 2013, was $137.1 million, which primarily consisted of the acquisition of seven properties, the expansion at another property and tenant improvements performed at certain of our properties during the year ended December 31, 2013, as compared to net cash used in investing activities during the year ended December 31, 2012, of $92.0 million, which primarily consisted of the acquisition of eight properties, coupled with tenant improvements performed at certain of our properties and net payments to our lenders for reserves.

Financing Activities

Net cash provided by financing activities during 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. Net cash provided by financing activities for the year ended December 31, 2012, was $70.8 million, which primarily consisted of proceeds from the sale of our Term Preferred Stock and proceeds from the issuance of mortgage notes payable, partially offset by distributions paid to our stockholders, principal repayments on mortgage notes payable and net repayments on our Prior Line of Credit.

Line of Credit

In August 2013, we procured the $60.0 million New Line of Credit, with Keybank National Association serving as a revolving lender, a letter of credit issuer and an administrative agent and Citizens Bank of Pennsylvania as an additional lender. Commerica Bank was subsequently added as an additional lender in December 2013. The New Line of Credit initially matures in August 2016; 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 New Line of Credit replaced the Credit Agreement, dated as of December 28, 2010 with Capital One, N.A., as administrative agent, and the other lenders party thereto, or the Prior Line of Credit. The Prior Line of Credit provided for a senior secured revolving credit facility in the amount of $75.0 million and was originally scheduled to mature on December 28, 2013.

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The New Line of Credit has a letter of credit sublimit of up to $20.0 million. In addition, we may expand the New Line of Credit up to a total of $75.0 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 New 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 New 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 New 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 New 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 New Line of Credit. The availability under the New Line of Credit is also reduced by letters of credit used in the ordinary course of business. We may use the advances under the New Line of Credit for both general corporate purposes and the acquisition of new investments.

As of December 31, 2013, there was $24.4 million outstanding under our New Line of Credit at an interest rate of approximately 3.4% and $10.3 million outstanding under letters of credit at a weighted average interest rate of 3.4%. As of February 18, 2014, the maximum additional amount we could draw was $20.1 million. Our ability to increase the availability under our New Line of Credit is dependent upon us adding additional properties to the unencumbered pool, which must meet predetermined eligibility standards. We were in compliance with all covenants under the New Line of Credit as of December 31, 2013.

Contractual Obligations

The following table reflects our material contractual obligations as of December 31, 2013 (in thousands):

		Payments Due by Period			
Contractual Obligations	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Debt Obligations (1)	$ 484,779	$ 24,830	$ 155,525	$ 124,566	$ 179,858
Interest on Debt Obligations (2)	127,549	24,671	44,904	22,119	35,855
Operating Lease Obligations (3)	6,992	413	826	833	4,920
Purchase Obligations (4)	5,675	5,675			
Total	$ 624,995	$ 55,589	$ 201,255	$ 147,518	$ 220,633

(1) Debt obligations represent borrowings under our New Line of Credit, which represents $24.4 million of the debt obligation due in 2016, mortgage notes payable that were outstanding as of December 31, 2013, and amounts due to the holders of our Term Preferred Stock.

(2)

Interest on debt obligations includes estimated interest on our borrowings under our New Line of Credit, mortgage notes payable and interest due to the holders of our Term Preferred Stock. The balance and interest rate on our New 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, 2013.

(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 $5.3 million in 2014 to fund the expansion of the premises in our Canton, NC property, and tenant improvements at four properties

Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of December 31, 2013.

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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 New 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, 2013, 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, 2013. As of December 31, 2013, our effective average LIBOR was 0.17%; thus, a 1%, 2% or 3% decrease could not occur.

	(Dollars in Thousands)	
Interest Rate Change	Increase to Interest Expense	Net Decrease to Net Income
1% Increase to LIBOR	$ 310	$ (310)
2% Increase to LIBOR	619	(619)
3% Increase to LIBOR	898	(898)

As of December 31, 2013, the fair value of our mortgage debt outstanding was $421.8 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, 2013, had been one percentage point higher or lower, the fair value of those debt instruments on that date would have decreased or increased by $20.5 million and $15.1 million, respectively.

In the future, we may be exposed to additional effects of interest rate changes, primarily as a result of our New 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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Item 8. Financial Statements and Supplementary Data.

Index to Consolidated Financial Statements

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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 (1992)* 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, 2013.

The effectiveness of our internal control over financial reporting as of December 31, 2013 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

February 18, 2014

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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 statements of operations, shareholders equity and cash flows present fairly, in all material respects, the financial position of Gladstone Commercial Corporation and its subsidiaries at December 31, 2013 and December 31, 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents 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, 2013 based on criteria established in *Internal Control Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements and the financial statement schedule, 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 Control Over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, 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.

/s/ PricewaterhouseCoopers LLP

McLean, VA

February 18, 2014

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Gladstone Commercial Corporation

Consolidated Balance Sheets

(Dollars in Thousands, Except Share and Per Share Data)

	December 31, 2013	December 31, 2012
ASSETS		
Real estate, at cost	$ 642,353	$ 533,753
Less: accumulated depreciation	81,241	65,730
Total real estate, net	561,112	468,023
Lease intangibles, net	79,632	57,254
Cash and cash equivalents	8,546	5,546
Restricted cash	5,051	2,935
Funds held in escrow	8,653	7,591
Deferred rent receivable, net	18,905	15,124
Deferred financing costs, net	6,840	6,569
Other assets	1,786	1,737
TOTAL ASSETS	$ 690,525	$ 564,779
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES		
Mortgage notes payable	$ 422,602	$ 359,185
Borrowings under line of credit	24,400	25,000
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, 2013 and December 31, 2012, respectively	38,500	38,500
Deferred rent liability, net	6,015	5,379
Asset retirement obligation liability	3,884	3,755
Accounts payable and accrued expenses	2,359	4,715
Due to Adviser and Administrator (1)	1,360	1,175
Other liabilities	8,259	4,705
Total Liabilities	$ 507,379	$ 442,414
Commitments and contingencies (2)		
STOCKHOLDERS EQUITY		
Series A and B redeemable preferred stock, par value $0.001 per share; $25 per share liquidation preference; 2,300,000 shares	$ 2	$ 2

authorized and 2,150,000 shares issued and outstanding at December 31, 2013 and December 31, 2012, respectively				
Senior common stock, par value $0.001 per share; 7,500,000 shares authorized and 374,484 and 179,511 shares issued and outstanding at December 31, 2013 and December 31, 2012, respectively				
Common stock, par value $0.001 per share, 38,500,000 shares authorized and 15,662,414 and 11,083,584 shares issued and outstanding at December 31, 2013 and December 31, 2012, respectively		16		11
Additional paid in capital		298,751		215,470
Notes receivable - employee		(375)		(410)
Distributions in excess of accumulated earnings		(115,248)		(92,708)
Total Stockholders Equity		183,146		122,365
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	690,525	$	564,779

(1) Refer to Note 2 Related-Party Transactions

(2) Refer to Note 7 Commitments and Contingencies

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

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Gladstone Commercial Corporation

Consolidated Statements of Operations

(Dollars in Thousands, Except Per Share Data)

	For the year ended December 31, 2013	2012	2011
Operating revenues			
Rental income	$ 59,769	$ 50,915	$ 43,632
Tenant recovery revenue	1,574	355	344
Total operating revenues	61,343	51,270	43,976
Operating expenses			
Depreciation and amortization	22,827	16,831	14,149
Property operating expenses	3,348	1,588	986
Acquisitions related expense	768	949	700
Base management fee (1)	2,014	1,467	1,629
Incentive fee (1)	4,201	3,569	3,398
Administration fee (1)	1,467	1,118	1,024
General and administrative	1,655	1,594	1,497
Total operating expenses before credit to incentive fee	36,280	27,116	23,383
Credit to incentive fee (1)	(3,457)	(2,221)	(2,113)
Total operating expenses	32,823	24,895	21,270
Other income (expense)			
Interest expense	(24,351)	(20,226)	(17,076)
Distributions attributable to Series C mandatorily redeemable preferred stock	(2,743)	(2,515)	
Other income	101	127	84
Total other expense	(26,993)	(22,614)	(16,992)
Net income	1,527	3,761	5,714
Distributions attributable to Series A and B preferred stock	(4,094)	(4,093)	(4,094)
Distributions attributable to senior common stock	(300)	(113)	(62)
Net (loss) income available to common stockholders	$ (2,867)	$ (445)	$ 1,558

Earnings per weighted average share of common stock - basic & diluted			
(Loss) income from continuing operations (net of dividends attributable to preferred stock)	$ (0.22)	$ (0.04)	$ 0.15
Net (loss) income available to common stockholders	$ (0.22)	$ (0.04)	$ 0.15
Weighted average shares of common stock outstanding			
Basic	13,164,244	10,953,325	10,236,859
Diluted	13,164,244	10,953,325	10,288,711
Earnings per weighted average share of senior common stock	$ 1.04	$ 1.06	$ 1.05
Weighted average shares of senior common stock outstanding - basic	287,178	106,721	59,258

(1) Refer to Note 2 Related-Party Transactions

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

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Gladstone Commercial Corporation

Consolidated Statements of Stockholders Equity

(Dollars in Thousands)

	Preferred Stock	Senior Common Stock	Common Stock	Capital in Excess of Par Value	Notes Receivable from Employees	Distributions in Excess of Accumulated Earnings	Total Stockholders Equity
Balance at December 31, 2010	$ 2	$	$ 9	$ 174,261	$ (963)	$ (61,934)	$ 111,375
Issuance of common stock, net			2	37,292			37,294
Repayment of principal on employee notes receivable					541		541
Distributions declared to common, senior common and preferred stockholders						(19,610)	(19,610)
Net income						5,714	5,714
Balance at December 31, 2011	$ 2	$	$ 11	$ 211,553	$ (422)	$ (75,830)	$ 135,314
Issuance of senior common stock and common stock, net				3,917			3,917
Repayment of principal on employee notes receivable					12		12
Distributions declared to common, senior common and preferred stockholders						(20,639)	(20,639)
Net income						3,761	3,761
Balance at December 31, 2012	$ 2	$	$ 11	$ 215,470	$ (410)	$ (92,708)	$ 122,365
Issuance of senior common stock and common stock, net			5	83,281			83,286

Repayment of principal on employee notes receivable					35		35
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	$	$ 16	$ 298,751	$ (375)	$ (115,248)	$ 183,146

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

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Gladstone Commercial Corporation

Consolidated Statements of Cash Flows

(Dollars in Thousands)

	For the year ended December 31, 2013	2012	2011
Cash flows from operating activities:			
Net income	$ 1,527	$ 3,761	$ 5,714
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	22,827	16,831	14,149
Amortization of deferred financing costs	1,780	1,502	918
Amortization of deferred rent asset and liability, net	(333)	(772)	(616)
Amortization of discount and premium on assumed debt	(171)	9	94
Asset retirement obligation expense	129	168	157
Increase in other assets	(399)	(211)	(142)
Increase in deferred rent liability		2,510	1,626
Increase in deferred rent receivable	(3,700)	(2,144)	(1,394)
(Decrease) increase in accounts payable, accrued expenses, and amount due Adviser and Administrator	(2,171)	2,746	(504)
Increase (decrease) in other liabilities	1,437	743	(340)
Leasing commissions paid	(1,041)	(1,738)	(6)
Net cash provided by operating activities	19,885	23,405	19,656
Cash flows from investing activities:			
Acquisition of real estate and related intangible assets	(131,188)	(82,239)	(42,681)
Improvements of existing real estate	(5,176)	(5,557)	(1,844)
Receipts from lenders for funds held in escrow	5,545	1,959	