UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTER ENDED JUNE 30, 2005**

OR

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

COMMISSION FILE NUMBER: 0-50363

GLADSTONE COMMERCIAL CORPORATION

(Exact name of registrant as specified in its charter)

MARYLAND	**02-0681276**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1521 WESTBRANCH DRIVE, SUITE 200
MCLEAN, VIRGINIA 22102
(Address of principal executive office)

(703) 287-5800
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes☑ No ☐.

The number of shares of the issuer's Common Stock, $0.001 par value, outstanding as of July 29, 2005 was 7,672,000.

GLADSTONE COMMERCIAL CORPORATION

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GLADSTONE COMMERCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	June 30, 2005	December 31, 2004
ASSETS		
Real estate, net	$ 94,245,941	$ 60,466,330
Mortgage note receivable	21,064,861	11,107,717
Cash and cash equivalents	216,434	29,153,987
Funds held in escrow	1,284,350	1,060,977
Interest receivable — mortgage note	67,619	64,795
Interest receivable — employees	5,236	4,792
Deferred rent receivable	4,293,573	210,846
Deferred financing costs	990,340	—
Prepaid expenses	101,677	170,685
Deposits on real estate	550,000	50,000
Other assets	5,304	64,819
Lease intangibles, net of accumulated amortization of $457,151 and $194,047, respectively	5,362,850	3,230,146
TOTAL ASSETS	$128,188,185	$ 105,585,094
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Due to Adviser	$ 124,171	$ 129,231
Accounts payable and accrued expenses	280,920	168,389
Dividends payable	—	920,040
Mortgage note payable	3,137,529	—
Borrowings under line of credit	22,010,000	—
Rent received in advance, security deposits and funds held in escrow	1,462,886	1,674,741
Total Liabilities	27,015,506	2,892,401
STOCKHOLDERS' EQUITY		
Common stock, $0.001 par value, 20,000,000 shares authorized and 7,672,000 and 7,667,000 shares issued and outstanding, respectively	7,672	7,667
Additional paid in capital	105,502,544	105,427,549
Notes receivable — employees	(433,789)	(375,000)
Distributions in excess of accumulated earnings	(3,903,748)	(2,367,523)
Total Stockholders' Equity	101,172,679	102,692,693
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$128,188,185	$ 105,585,094

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

GLADSTONE COMMERCIAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the three months ended June 30, 2005	For the three months ended June 30, 2004	For the six months ended June 30, 2005	For the six months ended June 30, 2004
OPERATING REVENUES				
Rental income	$2,235,241	$ 403,690	$4,082,248	$ 601,463
Interest income from mortgage note receivable	501,645	278,980	797,228	412,400
Tenant recovery revenue	39,557	—	41,600	—
Total operating revenues	2,776,443	682,670	4,921,076	1,013,863
OPERATING EXPENSES				
Depreciation and amortization	696,976	126,772	1,234,731	206,101
Management advisory fee	483,794	280,122	955,655	509,538
Professional fees	16,759	66,973	348,003	275,430
Taxes and licenses	25,441	2,250	153,714	12,570
Insurance	67,021	64,488	137,404	128,975
Interest	254,803	—	291,022	—
General and administrative	97,836	172,313	230,664	277,263
Total operating expenses	1,642,630	712,918	3,351,193	1,409,877
Income (loss) from operations	1,133,813	(30,248)	1,569,883	(396,014)
Interest income from temporary investments	13,192	162,523	107,713	334,985
Interest income — employee loans	5,236	—	9,921	—
Loss on foreign currency translation	(2,710)	—	(2,802)	—
Other income	15,718	162,523	114,832	334,985
NET INCOME (LOSS)	$1,149,531	$ 132,275	$1,684,715	$ (61,029)
Earnings (loss) per weighted average common share				
Basic	$ 0.15	$ 0.02	$ 0.22	$ (0.01)
Diluted	$ 0.15	$ 0.02	$ 0.22	$ (0.01)
Weighted average shares outstanding				
Basic	7,669,802	7,642,000	7,668,409	7,642,000
Diluted	7,692,639	7,695,134	7,715,100	7,764,732

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

GLADSTONE COMMERCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the six months ended June 30, 2005	For the six months ended June 30, 2004
Cash flows from operating activities:		
Net income (loss)	$ 1,684,715	$ (61,029)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,234,731	206,101
Changes in assets and liabilities:		
Amortization of deferred financing costs	74,836	—
Amortization of deferred rent asset	93,385	—
Increase in mortgage interest receivable	(2,824)	(61,950)
Increase in employee interest receivable	(444)	—
Decrease in prepaid expenses	69,008	122,500
Decrease (increase) in other assets	59,515	(25,000)
Increase in deferred rent receivable	(206,246)	(41,535)
Increase in accounts payable and accrued expenses	112,530	55,814
Decrease in due to Adviser	(5,060)	(131,085)
(Decrease) increase in rent received in advance and security deposits	(435,228)	293,592
Net cash provided by operating activities	2,678,918	357,408
Cash flows from investing activities:		
Acquisition of real estate	(41,116,911)	(22,265,178)
Issuance of mortgage note receivable	(10,000,000)	(11,170,000)
Deposit on future acquisition	(550,000)	—
Principal repayments on mortgage note receivable	42,856	19,213
Net cash used in investing activities	(51,624,055)	(33,415,965)
Cash flows from financing activities:		
Offering costs	—	(7,730)
Proceeds from borrowings under mortgage note payable	3,150,000	—
Principal repayments on mortgage note payable	(12,471)	—
Borrowings from line of credit	22,010,000	—
Principal repayments on employee loans	16,211	—
Payments for deferred financing costs	(1,015,176)	—
Dividends paid	(4,140,980)	(993,460)
Net cash provided by (used in) financing activities	20,007,584	(1,001,190)
Net decrease in cash and cash equivalents	(28,937,553)	(34,059,747)
Cash and cash equivalents, beginning of period	29,153,987	99,075,765
Cash and cash equivalents, end of period	$ 216,434	$ 65,016,018
NON-CASH FINANCING ACTIVITIES		
Cash paid during period for interest	$ 128,878	$ —
Notes receivable issued in exchange for common stock associated with the exercise of employee stock options	$ 75,000	$ —

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

GLADSTONE COMMERCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Significant Accounting Policies

Gladstone Commercial Corporation, a Maryland corporation, (the "Company") was incorporated on February 14, 2003 under the General Corporation Law of Maryland for the purpose of engaging in the business of investing in property net leased to creditworthy entities and making mortgage loans to creditworthy entities. Subject to certain restrictions and limitations, the business of the Company is managed by Gladstone Management Corporation (the "Adviser").

Subsidiaries

On May 28, 2003, the Company completed the formation of a subsidiary, Gladstone Commercial Limited Partnership (the "Operating Partnership"). The Company conducts substantially all of its operations through the Operating Partnership. As the Company currently owns all of the general and limited partnership interests of the Operating Partnership, the financial position and results of operations of the Operating Partnership are consolidated with those of the Company.

On January 27, 2004, the Company completed the formation of a subsidiary, Gladstone Lending LLC ("Gladstone Lending"). Gladstone Lending was created to conduct all operations related to real estate mortgage loans of the Company. As the Operating Partnership currently owns all of the membership interests of Gladstone Lending, the financial position and results of operations of Gladstone Lending are consolidated with those of the Operating Partnership.

On August 23, 2004, the Company completed the formation of a subsidiary, Gladstone Commercial Advisers, Inc. ("Commercial Advisers"). Commercial Advisers is a taxable REIT subsidiary, which was created to collect all non-qualifying income related to the Company's real estate portfolio. This income will predominately consist of fees received by the Company related to the leasing of real estate. Since the Company owns 100% of the voting securities of Commercial Advisers, the financial position and results of operations of Commercial Advisers are consolidated with those of the Company. There have been no such fees earned to date.

Interim financial information

Interim financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with GAAP are omitted. In the opinion of management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair statement of financial statements for the interim period have been included.

Investments in real estate

The Company records investments in real estate at cost and capitalizes improvements and replacements when they extend the useful life or improve the efficiency of the asset. The Company expenses costs of repairs and maintenance as incurred. The Company computes depreciation using the straight-line method over the estimated useful life of 39 years for buildings and improvements, five to seven years for equipment and fixtures and the shorter of the useful life or the remaining lease term for tenant improvements and leasehold interests. Real estate depreciation expense was $547,984 and $971,627 for the three and six months ended June 30, 2005, respectively, and $102,588 and $168,331 for the three and six months ended June 30, 2004, respectively.

The Company accounts for its acquisitions of real estate in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 141, *Business Combinations*, which requires the purchase price of real estate to be allocated to the acquired tangible assets, consisting of land, building and tenant improvements, and identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, other value of in-place leases and value of tenant relationships, based in each case on their fair values.

The Company allocates purchase price to the fair value of the tangible assets of an acquired property (which includes the land, building, and tenant improvements) to be determined by valuing the property as if it were vacant. The “as-if-vacant” value is allocated to land, building, and tenant improvements based on management’s determination of the relative fair values of these assets.

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

The value of in-place leases is amortized to expense over the initial term of the respective leases, which range from five to twenty years. The value of customer relationship intangibles are amortized to expense over the initial term and any renewal periods in the respective leases, but in no event does the amortization period for intangible assets exceed the remaining depreciable life of the building. Should a tenant terminate its lease, the unamortized portion of the in-place lease value and customer relationship intangibles will be charged to expense. Total amortization expense was $148,991 and $263,104 for the three and six months ended June 30, 2005, respectively, and $24,184 and $37,771 for three and six months ended June 30, 2004, respectively.

Above-market and below-market in-place lease values for owned properties are recorded based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management’s estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. The capitalized above-market lease values (presented in the accompanying balance sheet as deferred rent receivable) will be amortized as a reduction of rental income over the remaining non-cancelable terms of the respective leases. The capitalized below-market lease values (presented in the accompanying balance sheet as value of assumed lease obligations) are amortized as an increase to rental income over the initial term and any fixed-rate renewal periods in the respective leases. Total amortization expense related to above-market lease values was $87,250 and $93,385 for the three and six months ended June 30, 2005. There was no amortization expense related to above-market lease values in 2004.

Management’s estimates of value are made using methods similar to those used by independent appraisers (e.g., discounted cash flow analysis). Factors considered by management in its analysis include an estimate of carrying costs during hypothetical expected lease-up periods considering current market conditions, and costs to execute similar leases. The Company also considers information obtained about each property as a result of its pre-acquisition due diligence, marketing and leasing activities in estimating the fair value of the tangible and intangible assets 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 expected lease-up periods, which primarily range from six to 18 months, depending on specific local market conditions. Management also estimates costs to execute similar leases including leasing commissions, legal and other related expenses to the extent that such costs are not already incurred in connection with a new lease origination as part of the transaction. These estimated leasing commissions are summarized in the table below as leasing costs.

The following table summarizes the gross value of customer relationship intangibles:

	June 30, 2005	December 31, 2004
In-place leases	$3,375,600	$ 1,929,800
Leasing costs	2,444,401	1,494,393
Accumulated amortization	(457,151)	(194,047)
	$5,362,850	$ 3,230,146

Impairment

Investments in Real Estate

The Company accounts for the impairment of real estate in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which requires that the Company 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. If circumstances support the possibility of impairment, the Company prepares a projection of the undiscounted future cash flows, without interest charges, of the specific property and determines if the investment in such property is recoverable. If impairment is indicated, the carrying value of the property is written down to its estimated fair value based on the Company's best estimate of the property's discounted future cash flows. There have been no impairments recognized on the Company's real estate assets at June 30, 2005.

Provision for Loan Losses

The Company's accounting policies require that it reflect in its financial statements an allowance for estimated credit losses with respect to mortgage loans it has made based upon its evaluation of known and inherent risks associated with its private lending assets. The Company has extended two mortgage loans and has not experienced any actual losses in connection with its lending investments. Management reflects provisions for loan losses based upon its assessment of general market conditions, its internal risk management policies and credit risk rating system, industry loss experience, its assessment of the likelihood of delinquencies or defaults, and the value of the collateral underlying its investments. Actual losses, if any, could ultimately differ from these estimates. There are no provisions for loan losses at June 30, 2005.

Cash and cash equivalents

The Company considers all short-term, highly liquid investments that are both readily convertible to cash and have a maturity of generally three months or less at the time of purchase to be cash equivalents; except that any such investments purchased with funds on deposit in escrow or similar accounts are classified as restricted deposits. Items classified as cash equivalents include commercial paper and money-market funds. All of the Company's cash and cash equivalents at June 30, 2005 were held in the custody of two financial institutions, and the Company's balance at times may exceed federally insurable limits. The Company mitigates this risk by depositing funds with major financial institutions.

Deferred financing costs

Deferred financing costs consist of costs incurred to obtain long-term financing. These costs consist of legal fees, origination fees, and administrative fees incurred in association with the long-term financing. The costs are deferred and amortized using the straight-line method, which approximates the effective interest method, over the term of the financing secured.

Revenue recognition

Rental revenues include rents that each tenant pays in accordance with the terms of its respective lease reported on a straight-line basis over the non-cancelable term of the lease. Certain of the Company's leases currently contain rental increases at specified intervals, and straight-line basis accounting requires the Company to record an asset, and include in revenues, deferred rent receivable that will be received if the tenant makes all rent payments required through the expiration of the initial term of the lease. Deferred rent receivable in the accompanying balance sheets represents the cumulative difference between rental revenue as recorded on a straight line basis and rents received from the tenants in accordance with the lease terms. Accordingly, the Company determines, in its judgment, to what extent the deferred rent receivable applicable to each specific tenant is collectible. The Company reviews deferred rent receivable on a quarterly basis and takes into consideration the tenant's payment history, the financial condition of the tenant, business conditions in the industry in which the tenant operates and economic conditions in the area in which the property is located. In the event that the collectability of deferred rent with respect to any given tenant is in doubt, the Company records an increase in the allowance for uncollectible accounts or records a direct write-off of the specific rent receivable, which would have an adverse effect on the net income for the year in which the reserve is increased or the direct write-off is recorded and would decrease total assets and stockholders' equity. No such reserves have been recorded as of June 30, 2005.

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

Stock based compensation

The Company currently accounts for the issuance of stock options under its 2003 Equity Incentive Plan (the "2003 Plan"), in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees." In this regard, these options have been granted to individuals who are the Company's officers, and who would qualify as leased employees under FASB Interpretation No. 44 ("FIN 44"), "Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No. 25."

In December 2004, the Financial Accounting Standards Board ("FASB") approved the revision of SFAS No. 123, "Accounting for Stock-Based Compensation, and issued the revised SFAS No. 123(R), "Share-Based Payment." In April of 2005 the effective date of adoption was changed from interim periods ending after June 15, 2005 to annual periods beginning after June 15, 2005. SFAS No. 123(R) effectively replaces SFAS No. 123, and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." The new standard is effective for awards that are granted, modified, or settled in cash for annual periods beginning after June 15, 2005. The adoption of SFAS No. 123(R) will require the Company to begin expensing the value of stock options granted as compensation cost beginning in January of 2006. The impact of the adoption of this amendment to current earnings is discussed below.

The following table summarizes the Company's operating results as if the Company elected to account for its stock-based compensation under the fair value provisions of SFAS No. 123(R), "Share-Based Payment," for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30, 2005	For the three months ended June 30, 2004	For the six months ended June 30, 2005	For the six months ended June 30, 2004
Net income (loss), as reported	$1,149,531	$ 132,275	$1,684,715	$ (61,029)
Less: Stock-based compensation expense determined using the fair value based method	(43,971)	(217,587)	(93,659)	(411,430)
Net income (loss), pro-forma	$1,105,560	$ (85,312)	$1,591,056	$ (472,459)
Basic, as reported	$ 0.15	$ 0.02	$ 0.22	$ (0.01)
Basic, pro-forma	$ 0.14	$ (0.01)	$ 0.21	$ (0.06)
Diluted, as reported	$ 0.15	$ 0.02	$ 0.22	$ (0.01)
Diluted, pro-forma	$ 0.14	$ (0.01)	$ 0.21	$ (0.06)

The stock-based compensation expense under the fair value method, as reported in the above table, was computed using an estimated weighted average fair value of $1.26 using the Black-Scholes option-pricing model, based on options issued from date of inception forward, and the following weighted-average assumptions: dividend yield of 5.07%, risk-free interest rate of 2.61%, expected volatility factor of 18.16%, and expected lives of 3 years.

Income taxes

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

Gladstone Commercial Advisers is a wholly-owned taxable REIT subsidiary ("TRS") that is subject to federal and state income taxes. The Company accounts for such income taxes in accordance with the provisions of SFAS No. 109. Under SFAS No. 109, the Company accounts for income taxes using the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases.

Segment information

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" provides standards for public companies relating to the reporting of financial and descriptive information about their operating segments in financial statements. Operating segments are defined as components of an enterprise for which separate financial information is available and is evaluated regularly by the chief operating decision maker or decision making group in determining how to allocate resources and in assessing performance. Company management is the chief decision making group. As discussed in Note 8, the Company's operations are derived from two operating segments, one segment purchases real estate (land, buildings and other improvements), which is simultaneously leased to existing users and the other segment extends mortgage loans and collects principal and interest payments

Foreign Currency Transactions

The Company purchased two properties in Canada in October of 2004. Rental payments from these properties are received in Canadian Dollars. In accordance with SFAS No. 52 "Foreign Currency Translation," the rental revenue received is recorded using the exchange rate as of the transaction date, which is the first day of each month. Straight line rent and any deferred rent asset or liability are also recorded using the exchange rate as of the transaction date. If the rental payment is received on a date other than the transaction date, then a foreign currency gain or loss would be recorded on the financial statements. All deferred rent assets are re-valued at each balance sheet date to reflect the current exchange rate. For the three and six months ended June 30, 2005, $2,710 and $2,802, respectively, was recorded as a foreign currency loss, resulting from rental payments being received on dates other than the transaction date and the valuation of deferred rent at the end of the quarter.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

Certain amounts from prior years' financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on previously reported net income or stockholders' equity.

2. Management Advisory Fee

The Company has no employees, and all of the Company's operations are managed by the Company's Adviser pursuant to an advisory agreement. Pursuant to the advisory agreement, the Adviser is responsible for managing the Company on a day-to-day basis and for identifying, evaluating, negotiating and consummating investment transactions consistent with the Company's criteria. In exchange for such services, the Company pays the Adviser a management advisory fee, which consists of the reimbursement of certain expenses of the Adviser. The Company reimburses the Adviser for its pro-rata share of the payroll and related benefit expenses on an employee-by-employee basis, based on the percentage of each employee's time devoted to Company matters. The Company also reimburses the Adviser for general overhead expenses multiplied by the ratio of hours worked by Adviser employees on Company matters to the total hours worked by the Adviser's employees.

The Company compensates its Adviser through reimbursement of its portion of the Adviser's payroll, benefits and general overhead expenses. This reimbursement is generally subject to a combined annual management fee limitation of 2.0% of the Company's average invested assets for the year, with certain exceptions. Reimbursement for overhead expenses is only required up to the point that reimbursed overhead expenses and payroll and benefits expenses, on a combined basis, equal 2.0% of the Company's average invested assets for the year, and general overhead expenses are required to be reimbursed only if the amount of payroll and benefits reimbursed to the Adviser is less than 2.0% of its average invested assets for the year. However, payroll and benefits expenses are required to be reimbursed by the Company to the extent that they exceed the overall 2.0% annual management fee limitation. Additionally, in the event that overhead expenses exceed the combined limitation, the Company's independent directors may authorize reimbursement of the full amount of such excess overhead expenses, or any portion thereof, if they determine that the excess expenses were justified based on unusual and nonrecurring factors which they deem sufficient. The Company may reimburse the Adviser only to the extent that the reimbursement would not cause the Company's overhead expense reimbursements to exceed the 2.0% limitation in any year. To date, the advisory fee has not exceeded the annual cap.

For the three and six months ended June 30, 2005, the Company incurred approximately $484,000 and $956,000, respectively, in management advisory fees. For the three and six months ended June 30, 2004, the Company incurred approximately $280,000 and $510,000, respectively, in management advisory fees. Approximately $124,000 and $129,000 was unpaid at June 30, 2005 and December 31, 2004, respectively.

The following table shows the breakdown of the management advisory fee for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30, 2005	For the three months ended June 30, 2004	For the six months ended June 30, 2005	For the six months ended June 30, 2004
Allocated payroll and benefits	$ 334,563	$ 215,414	$ 681,877	$ 381,252
Allocated overhead expenses	$ 149,231	$ 64,708	$ 273,778	$ 128,286
Total management advisory fee	$ 483,794	$ 280,122	$ 955,655	$ 509,538

3. Stock Options

At June 30, 2005, 922,000 options were outstanding with exercise prices ranging from $15 to $16.85 with terms of ten years.

The following table is a summary of all notes issued to employees for the exercise of stock options:

Date Issued	Number of Options Exercised	Strike Price of Options Exercised	Amount of Promissory Note	Term of Note	Interest Rate on Note
Sep-04	25,000	$ 15.00	$375,000	9 years	5.0%
May-05	5,000	$ 15.00	$ 75,000	9 years	6.0%

These notes were recorded as loans to employees in the equity section of the accompanying consolidated balance sheets. No compensation expense was recorded related to this transaction. As of June 30, 2005, approximately $434,000 of indebtedness was owed by current employees to the Company, and no current or former directors or executive officers had any loans outstanding.

4. Earnings Per Common Share

The following tables set forth the computation of basic and diluted earnings (loss) per share for the three and six months ended June 30, 2005 and 2004:

	For the three months ended June 30, 2005	For the three months ended June 30, 2004	For the six months ended June 30, 2005	For the six months ended June 30, 2004
Net income (loss)	$1,149,531	$ 132,275	$1,684,715	$ (61,029)
Denominator for basic weighted average shares	7,669,802	7,642,000	7,668,409	7,642,000
Dilutive effect of stock options (a)	22,837	53,134	46,691	—
Denominator for diluted weighted average shares	7,692,639	7,695,134	7,715,100	7,642,000
Basic earnings (loss) per common share	$ 0.15	$ 0.02	$ 0.22	$ (0.01)
Diluted earnings (loss) per common share	$ 0.15	$ 0.02	$ 0.22	$ (0.01)

(a) The incremental shares related to stock options for the six months ended June 30, 2004 have an anti-dilutive effect and as a result are not included in the calculation.

5. Real Estate

A summary of all properties held by the Company as of June 30, 2005 is as follows:

Date Acquired	Location	Square Footage (unaudited)	Property Description	Net Real Estate
Dec-03	Raleigh, North Carolina	58,926	Office	$ 5,124,392
Jan-04	Canton, Ohio	54,018	Office and Warehouse	3,532,852
Apr-04	Akron, Ohio	83,891	Office and Laboratory	8,460,518
Jun-04	Charlotte, North Carolina	64,500	Office	9,114,725
Jul-04	Canton, North Carolina	228,000	Commercial and Manufacturing	5,073,297
Aug-04	Snyder Township, Pennsylvania	290,000	Commercial and Warehouse	6,513,848
Aug-04	Lexington, North Carolina	154,000	Commercial and Warehouse	2,913,860
Sep-04	Austin, Texas	51,993	Flexible Office	7,201,602
Oct-04	Norfolk, Virginia	25,797	Commercial and Manufacturing	913,513
Oct-04	Mt. Pocono, Pennsylvania	223,275	Commercial and Manufacturing	6,079,581
Oct-04	Granby, Quebec	99,981	Commercial and Manufacturing	2,994,265
Oct-04	Montreal, Quebec	42,490	Commercial and Manufacturing	1,833,016
Feb-05	San Antonio, Texas	60,245	Flexible Office	8,273,734
Feb-05	Columbus, Ohio	39,000	Industrial	2,769,481
Apr-05	Big Flats, New York	120,000	Industrial	6,723,157
May-05	Wichita, Kansas	69,287	Office	11,187,434
May-05	Arlington, Texas	64,000	Warehouse and Bakery	3,177,894
Jun-05	Dayton, Ohio	59,894	Office	2,358,772
				$94,245,941

The following table sets forth the components of the Company's investments in real estate:

	June 30, 2005	December 31, 2004
Real estate:		
Land	$11,547,000	$ 7,669,000
Building	82,195,997	52,641,933
Tenant improvements	2,259,695	940,522
Accumulated depreciation	(1,756,751)	(785,125)
Real estate, net	$94,245,941	$ 60,466,330

On February 10, 2005, the Company acquired a 60,245 square foot flexible office building in San Antonio, Texas for $9.0 million, including transaction costs, and the purchase was funded using a portion of the net proceeds from the Company's initial public offering. Upon acquisition of the property, the Company was assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately nine years at the time of assignment. The lease provides for annual rents of approximately $753,000 through 2008, with prescribed escalations thereafter.

On February 10, 2005, the Company acquired a 39,000 square foot industrial building in Columbus, Ohio for $3.4 million, including transaction costs, and the purchase was funded using a portion of the net proceeds from the Company's initial public offering. Upon acquisition of the property, the Company was assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately ten years at the time of assignment. The lease provides for annual rents of approximately $318,000 through 2006, with prescribed escalations thereafter.

On April 15, 2005, the Company acquired a 120,000 square foot industrial building in Big Flats, New York for $7.1 million, including transaction costs, and the purchase was funded using a portion of the net proceeds from the Company's initial public offering. Upon acquisition of the property, the Company was assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately eight years at the time of assignment. The lease provides for annual rents of approximately $616,000 through 2006, with prescribed escalations thereafter.

On May 18, 2005, the Company acquired the leasehold interest in a 69,287 square foot office building in Wichita, Kansas for $13.4 million, including transaction costs, and the purchase was funded using borrowings from the Company's line of credit and proceeds the Company received from the long-term mortgage on the Canton, North Carolina property. Under the terms of the leasehold interest, the Company has a capital lease with the City of Wichita because of the bargain purchase option contained within the lease that gives the Company the right to purchase the land and building for $1,000. Upon acquisition of the leasehold interest in the building, the Company was assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately seven years at the time of assignment, and the tenant has two options to extend the lease for additional periods of five years each. The lease provides for annual rents of approximately $1.3 million through 2006, with prescribed escalations thereafter.

On May 26, 2005, the Company acquired a 64,000 square foot warehouse and bakery in Arlington, Texas for $5.3 million, including transaction costs, and the purchase was funded using borrowings from the Company's line of credit. Upon acquisition of the property, the Company was assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately eight years at the time of assignment, and the tenant has two options to extend the lease for additional periods of five years each. The lease provides for annual rents of approximately $521,000 through 2006, with prescribed escalations thereafter.

On June 30, 2005, the Company acquired a 59,894 square foot office building in Dayton, Ohio for $2.7 million, including transaction costs, and the purchase was funded using borrowings from the Company's line of credit. Upon acquisition of the property, the Company was assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately thirteen years at the time of assignment, with the ability to terminate the lease in eight years with six months notice prior to the effective date of termination to the Company. The tenant also has two options to extend for additional periods of five years each. The lease provides for annual rents of approximately $240,000 through 2006, with prescribed escalations thereafter.

In accordance with SFAS No. 141, “Business Combinations,” the Company allocated the purchase price of the properties acquired during the six months ended June 30, 2005 as follows:

	Land	Building	Tenant Improvements	Lease Intangibles	Deferred Rent Asset	Total Purchase Price
San Antonio, Texas	$ 843,000	$ 6,817,984	$ 718,439	$ 664,218	—	$ 9,043,641
Columbus, Ohio	410,000	2,379,947	5,161	243,063	395,000	3,433,171
Big Flats, New York	275,000	6,489,630	—	337,589	—	7,102,219
Wichita Kansas	1,525,000	9,586,889	119,182	606,701	1,587,822	13,425,594
Arlington, Texas	300,000	2,858,509	32,254	151,496	1,987,044	5,329,303
Dayton, Ohio	525,000	1,389,635	444,137	392,741	—	2,751,513
	$3,878,000	$29,522,594	$1,319,173	$2,395,808	$3,969,866	$41,085,441

Future operating lease payments under non-cancelable leases, excluding customer reimbursement of expenses, in effect at June 30, 2005 are as follows:

Year	Rental Payments
2005	$ 5,107,931
2006	10,281,992
2007	10,412,536
2008	10,590,754
2009	9,592,403
Thereafter	60,263,605

Lease payments for certain properties, where payments are denominated in Canadian dollars, have been translated to US dollars using the exchange rate as of June 30, 2005 for the purposes of the table above.

In accordance with the lease terms, substantially all tenant expenses are required to be paid by the tenant, however the Company would be required to pay property taxes on the respective property in the event the tenant fails to pay them. The total property taxes, on an annual basis, for all properties and loans outstanding as of June 30, 2005 is summarized in the table below:

Location	Real Estate Taxes
Raleigh, North Carolina	$ 45,743
Canton, Ohio	6,374
Sterling Heights, Michigan	115,998
Akron, Ohio	81,933
Charlotte, North Carolina	56,438
Canton, North Carolina	47,877
Snyder Township, Pennsylvania	99,222
Lexington, North Carolina	21,102
Austin, Texas	167,499
Norfolk, Virginia	11,411
Mt. Pocono, Pennsylvania	115,232
Granby, Quebec	36,178
Montreal, Quebec	77,605
San Antonio, Texas	159,551
Columbus, Ohio	37,610
Big Flats, New York	24,594
McLean, Virginia	74,563
Wichita, Kansas	5,222
Arlington, Texas	63,520
Dayton, Ohio	49,156
	$ 1,296,828

6. Mortgage Note Receivable

On February 18, 2004, the Company extended a promissory mortgage note in the amount of $11,170,000 collateralized by property in Sterling Heights, Michigan. The note was issued from a portion of the net proceeds of the Company's initial public offering. The note accrues interest at the greater of 11% per year or the one month LIBOR rate plus 5% per year, and is for a period of 10 years maturing on February 18, 2014. At June 30, 2005, the outstanding balance of the note was $11,064,861.

On April 15, 2005, the Company extended a mortgage loan in the amount of $10.0 million on an office building in McLean, Virginia, where the Company's Adviser is a subtenant in the building. The loan was funded using a portion of the net proceeds from the Company's initial public offering. This 12 year mortgage loan, collateralized by the McLean property, accrues interest at the greater of 7.5% per year or the one month LIBOR rate plus six percent per year, with a ceiling of 10.0%. The mortgage loan is interest only for the first six years of the term, with payments of principal commencing after the initial period. The balance of the principal and all interest remaining is due at the end of the 12 year term.

7. Dividends Declared per Share

The Company commenced paying a monthly dividend in 2005. The following table summarizes the dividends paid during the six months ended June 30, 2005, and those dividends declared subsequent to the quarter end for July, August and September of 2005.:

Record Date	Payment Date	Dividend per Share
January 17, 2005	January 31, 2005	$ 0.06
February 14, 2005	February 25, 2005	$ 0.06
March 16, 2005	March 30, 2005	$ 0.06
April 15, 2005	April 29, 2005	$ 0.08
May 13, 2005	May 27, 2005	$ 0.08
June 16, 2005	June 30, 2005	$ 0.08
July 21, 2005	July 29, 2005	$ 0.08
August 23, 2005	August 31, 2005	$ 0.08
September 22, 2005	September 30, 2005	$ 0.08

8. Segment Information

As of June 30, 2005, the Company's operations are derived from two operating segments. One segment purchases real estate (land, buildings and other improvements), which is simultaneously leased to existing users and the other segment extends mortgage loans and collects principal and interest payments. The following table summarizes the Company's consolidated operating results and total assets by segment as of and for the three and six months ended June 30, 2005 and 2004:

	As of and for the Three Months Ended June 30, 2005				As of and for the Six Months Ended June 30, 2005			
	Real Estate Leasing	Real Estate Lending	Other	Total	Real Estate Leasing	Real Estate Lending	Other	Total
Revenue	$ 2,274,798	$ 501,645	$ —	$ 2,776,443	$ 4,123,848	$ 797,228	$ —	$ 4,921,076
Expenses	722,417	—	920,213	1,642,630	1,388,445	—	1,962,748	3,351,193
Income (loss) from operations	1,552,381	501,645	(920,213)	1,133,813	2,735,403	797,228	(1,962,748)	1,569,883
Other income (loss)	(2,710)	—	18,428	15,718	(2,802)	—	117,634	114,832
Net income (loss)	$ 1,549,671	$ 501,645	$ (901,785)	$ 1,149,531	$ 2,732,601	$ 797,228	$(1,845,114)	$ 1,684,715
Total Assets	$104,452,364	$21,132,480	$2,603,341	$128,188,185	$104,452,364	$21,132,480	$ 2,603,341	$128,188,185

	As of and for the Three Months Ended June 30, 2004				As of and for the Six Months Ended June 30, 2004			
	Real Estate Leasing	Real Estate Lending	Other	Total	Real Estate Leasing	Real Estate Lending	Other	Total
Revenue	$ 403,690	$ 278,980	$ —	$ 682,670	$ 601,463	$ 412,400	$ —	$ 1,013,863
Expenses	126,772	—	586,146	712,918	206,101	—	1,203,776	1,409,877
Income (loss) from operations	276,918	278,980	(586,146)	(30,248)	395,362	412,400	(1,203,776)	(396,014)
Other income	—	—	162,523	162,523	—	—	334,985	334,985
Net income (loss)	$ 276,918	$ 278,980	$ (423,623)	$ 132,275	$ 395,362	$ 412,400	$ (868,791)	$ (61,029)
Total Assets	$27,894,784	$11,399,971	$65,109,950	$104,404,705	$27,894,784	$11,399,971	$65,109,950	$104,404,705

9. Line of Credit

On February 28, 2005, the Company entered into a line of credit agreement with a syndicate of banks led by Branch Banking & Trust Company. This line of credit initially provided the Company with up to $50 million of financing, with an option to increase the line of credit up to a maximum of $75 million upon agreement of the syndicate of banks. The line of credit matures on February 28, 2008. The interest rate charged on the advances under the facility is based on LIBOR, the prime rate or the federal funds rate, depending on market conditions, and adjusts periodically. The unused portion of the line of credit is subject to a fee of 0.25% per year. The Company's ability to access this funding source is subject to the Company continuing to meet customary lending requirements such as compliance with financial and operating covenants and meeting certain lending limits and, as of June 30, 2005, the Company is in compliance with all financial and operating covenants. For example, as is customary with such line of credit facilities, the maximum amount the Company may draw under this agreement is based on the percentage of the value of its properties meeting agreed-upon eligibility standards that the Company has pledged as collateral to the banks. As the Company arranges for long-term mortgages for these properties, the banks will release the properties from the line of credit and reduce the availability under the line of credit by the advanced amount of the removed property. Conversely, as the Company purchases new properties meeting the eligibility standards, the Company may pledge these new properties to obtain additional advances under this agreement. The Company may use the advances under the line of credit for both general corporate purposes and the acquisition of new investments. As of June 30, 2005, there was $22.0 million outstanding under the line of credit at an interest rate of 5.59%.

Subsequent to the end of the quarter, on July 6, 2005, the Company amended the line of credit to increase the maximum availability under the line from $50 million to $60 million. As of August 2, 2005, the Company may draw up to an aggregate of $58.3 million under this agreement, of which the Company has aggregate borrowings outstanding under the line of credit of $49.4 million .

10. Mortgage Note Payable

On March 16, 2005 the Company borrowed $3,150,000 pursuant to a long-term note payable from Key Bank National Association, which is collateralized by a security interest in its Canton, North Carolina property. The note accrues interest at an initial interest rate of 6.33% per year until the anticipated repayment date of April 1, 2010. Monthly payments on the note are based upon a twenty-five year term, with both principal and interest being paid each month. If the note is not repaid before the anticipated repayment date, interest will accrue on the remaining outstanding principal balance from and after the anticipated repayment date at the greater of the initial interest rate plus 2%, or the treasury rate for the week ending prior to the anticipated repayment date plus 2%. The Company may repay this note at any time after June 23, 2009 and not be subject to a prepayment penalty. The note matures on April 1, 2030, however the Company expects to repay the note in full prior to the anticipated repayment date. The Company used the proceeds from the note to acquire additional investments for its portfolio.

11. Subsequent Events

On July 7, 2005, the Company acquired a 30,268 square foot office building in Eatontown, New Jersey for $5.6 million, including transaction costs, and the purchase was funded using borrowings from the Company’s line of credit. Upon acquisition of the property, the Company was assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately six years at the time of assignment, and the tenant has two options to extend the lease for additional periods of five years each. The lease provides for annual rents of approximately $507,000 through 2006, with prescribed escalations thereafter.

On July 11, 2005, the Company acquired a 183,000 square foot office building in Franklin Township, New Jersey for $8.2 million, including transaction costs, and the purchase was funded using borrowings from the Company’s line of credit. The Company, upon acquisition of the property, extended a fifteen year triple net lease with the sole tenant, and the tenant has three options to extend the lease for additional periods of five years each. The lease also has a provision whereby the tenant may purchase the property from the Company on or around the eleventh anniversary of the purchase date for $9.1 million. The lease provides for annual rents of approximately $809,000 through 2006, with prescribed escalations thereafter.

On July 14, 2005, the Company acquired a 278,020 square foot office building in Duncan, South Carolina for $19.2 million, including transaction costs, and the purchase was funded using borrowings from the Company’s line of credit. Upon acquisition of the property, the Company was assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately six years at the time of assignment, and the tenant has two options to extend the lease for additional periods of five years each. The lease provides for annual rents of approximately $1.9 million through 2006, with prescribed escalations thereafter.

On July 19, 2005 the Company entered into two separate long-term notes payable with the RBC Life Insurance Company, which are collateralized by its Canadian Properties. The Company borrowed $2.1 million in Canadian dollars, which translated to $1.7 million in US Dollars as of July 19, 2005, and the loan is collateralized by a security interest in its Montreal, Quebec property. The Company borrowed an additional $3.4 million in Canadian dollars, which translated to $2.8 million in US Dollars as of July 19, 2005, and the loan is collateralized by a security interest in its Granby, Quebec property. These notes both accrue interest at an interest rate of 5.22% per year. Monthly payments on the notes are based upon a twenty-five year term, with both principal and interest being paid each month. The notes mature on August 1, 2015, and the Company does not have the right to prepay the principal amount prior to the maturity date on either note. The Company used the proceeds from the notes to pay down the line of credit.

Item 2. 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-Q.

Forward-Looking Statements

Some of the statements in this Quarterly Report onForm 10-Q constitute forward-looking statements under Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements made with respect to possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. When we use the words "believe," "expect," "anticipate," "estimate" or similar expressions, we intend to identify forward-looking statements. You should not place undue reliance on these forward-looking statements. Statements regarding the following subjects are forward-looking by their nature:

- *our business strategy;*
- *pending transactions;*
- *our projected operating results;*
- *our ability to obtain future financing arrangements;*
- *estimates relating to our future distributions;*
- *our understanding of our competition;*
- *market trends;*
- *estimates of our future operating expenses, including payments to our Adviser under the terms of our advisory agreement;*
- *projected capital expenditures; and*
- *use of the proceeds of our credit facilities, mortgage notes payable, and other future capital resources, if any.*

These statements involve known and unknown risks, uncertainties and other factors that may cause results, levels of activity, growth, performance, tax consequences or achievements to be materially different from any future results, levels of activity, growth, performance, tax consequences or achievements expressed or implied by such forward-looking statements.

The forward-looking statements are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. Although we believe that these beliefs, assumptions and expectations are reasonable, we cannot guarantee future results, levels of activity, performance, growth or achievements. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in or implied by our forward-looking statements. You should carefully consider these risks before you make an investment decision with respect to our common stock, along with the following factors that could cause actual results to vary from our forward-looking statements:

- *the loss of any of our key employees, such as Mr. David Gladstone, our chairman and chief executive officer, Mr. Terry Lee Brubaker, our president and chief operating officer, or Mr. George Stelljes III, our executive vice president and chief investment officer;*
- *general volatility of the capital markets and the market price of our common stock;*
- *risks associated with negotiation and consummation of pending and future transactions;*
- *changes in our business strategy;*
- *availability, terms and deployment of capital, including the ability to maintain and borrow under our existing credit facility, arrange for long-term mortgages on our properties; secure one or more additional long-term credit facilities, and to raise equity capital;*
- *availability of qualified personnel;*
- *changes in our industry, interest rates or the general economy; and*
- *the degree and nature of our competition.*

We are under no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results.

Overview

We were incorporated under the General Corporation Law of the State of Maryland on February 14, 2003 primarily for the purpose of investing in and owning net leased industrial and commercial rental property and selectively making long-term mortgage loans collateralized by industrial and commercial property. We expect that a large portion of our tenants and borrowers will be small and medium-sized businesses that have significant buyout fund ownership and will be well capitalized, with equity constituting between 20% and 40% of their permanent capital. We expect that other tenants and borrowers will be family-owned businesses that have built significant equity from paying down the mortgage loans securing their real estate or through the appreciation in the value of their real estate. We seek to enter into purchase agreements for real estate that have triple net leases with terms of approximately 15 years, with rent increases built into the leases. 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. At June 30, 2005, we owned eighteen properties and had two mortgage loans. We have also acquired three properties subsequent to June 30, 2005. We are actively communicating with buyout funds, real estate brokers and other third parties to locate properties for potential acquisition or mortgage financing in an effort to build our portfolio.

We conduct substantially all of our activities through, and all of our properties are held directly or indirectly by, Gladstone Commercial Limited Partnership, a Delaware limited partnership formed on May 28, 2003, which we refer to as our "Operating Partnership." We control our Operating Partnership through our wholly owned subsidiary Gladstone Commercial Partners, LLC, which serves as the Operating Partnership's sole general partner, and we also own all limited partnership units of our Operating Partnership. We expect our Operating Partnership to issue limited partnership units from time to time in exchange for industrial and commercial real property. By structuring our acquisitions in this manner, the sellers of the real estate will generally be able to defer the realization of gains until they redeem the limited partnership units. Limited partners who hold limited partnership units in our Operating Partnership will be entitled to redeem these units for cash or, at our election, shares of our common stock on a one-for-one basis at any time. Whenever we issue common stock for cash, we will be obligated to contribute any net proceeds we receive from the sale of the stock to our Operating Partnership and our Operating Partnership will, in turn, be obligated to issue an equivalent number of limited partnership units to us. Our Operating Partnership will distribute the income it generates from its operations to Gladstone Commercial Partners, LLC and its limited partners, including us, on a pro rata basis. We will, in turn, distribute the amounts we receive from our Operating Partnership to our stockholders in the form of monthly cash distributions. We have historically operated, and intend to continue to operate, so as to qualify as a REIT for federal tax purposes, thereby generally avoiding federal and state income taxes on the distributions we make to our stockholders.

Gladstone Management Corporation, a registered investment adviser and an affiliate of ours, serves as our external adviser (our "Adviser"). Our Adviser is responsible for managing our business on a day-to-day basis and for identifying and making acquisitions and dispositions that it believes meet our investment criteria.

Recent Events

On February 10, 2005, we acquired a 60,245 square foot flexible office building in San Antonio, Texas for $9.0 million, including transaction costs, and the purchase was funded using a portion of the net proceeds from our initial public offering. Upon acquisition of the property, we were assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately nine years at the time of assignment. The lease provides for annual rents of approximately $753,000 through 2008, with prescribed escalations thereafter.

On February 10, 2005, we acquired a 39,000 square foot industrial building in Columbus, Ohio for $3.4 million, including transaction costs, and the purchase was funded using a portion of the net proceeds from

our initial public offering . Upon acquisition of the property, we were assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately ten years at the time of assignment. The lease provides for annual rents of approximately $318,000 through 2006, with prescribed escalations thereafter.

On March 16, 2005 we borrowed $3,150,000 pursuant to a long-term note payable from Key Bank National Association, which is collateralized by a security interest in our Canton, North Carolina property. The note accrues interest at an initial interest rate of 6.33% per year until the anticipated repayment date of April 1, 2010. Monthly payments on the note are based upon a twenty-five year term, with both principal and interest being paid each month. If the note is not repaid before the anticipated repayment date, interest will accrue on the remaining outstanding principal balance from and after the anticipated repayment date at the greater of the initial interest rate plus 2%, or the treasury rate for the week ending prior to the anticipated repayment date plus 2%. We may repay this note at any time after June 23, 2009 and not be subject to a prepayment penalty. The note matures on April 1, 2030, however we expect to repay the note in full prior to the anticipated repayment date. We used the proceeds from the note to acquire additional investments for our portfolio.

On April 15, 2005, we acquired a 120,000 square foot industrial building in Big Flats, New York for $7.1 million, including transaction costs, and the purchase was funded using a portion of the net proceeds from our initial public offering. Upon acquisition of the property, we were assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately eight years at the time of assignment. The lease provides for annual rents of approximately $616,000 through 2006, with prescribed escalations thereafter.

On April 15, 2005, we extended a mortgage loan in the amount of $10.0 million on an office building in McLean, Virginia, where our Adviser is a subtenant in the building. The loan was funded using a portion of the net proceeds from our initial public offering. This 12 year mortgage loan, collateralized by the McLean property, accrues interest at the greater of 7.5% per year or the one month LIBOR rate plus six percent per year, with a ceiling of 10.0%. The mortgage loan is interest only for the first six years of the term, with payments of principal commencing after the initial period. The balance of the principal and all interest remaining is due at the end of the 12 year term.

On May 18, 2005, we acquired the leasehold interest in a 69,287 square foot office building in Wichita, Kansas for $13.4 million, including transaction costs, and the purchase was funded using borrowings from our line of credit and proceeds we received from the long-term mortgage on the Canton, North Carolina property. Under the terms of the leasehold interest, we have a capital lease with the City of Wichita because of the bargain purchase option contained within the lease that gives us the right to purchase the land and building for $1,000. Upon acquisition of the leasehold interest in the building, we were assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately seven years at the time of assignment, and the tenant has two options to extend the lease for additional periods of five years each. The lease provides for annual rents of approximately $1.3 million through 2006, with prescribed escalations thereafter.

On May 26, 2005, we acquired a 64,000 square foot warehouse and bakery in Arlington, Texas for $5.3 million, including transaction costs, and the purchase was funded using borrowings from our line of credit. Upon acquisition of the property, we were assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately eight years at the time of assignment, and the tenant has two options to extend the lease for additional periods of five years each. The lease provides for annual rents of approximately $521,000 through 2006, with prescribed escalations thereafter.

On June 30, 2005, we acquired a 59,894 square foot office building in Dayton, Ohio for $2.7 million, including transaction costs, and the purchase was funded using borrowings from our line of credit. Upon acquisition of the property, we were assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately thirteen years at the time of assignment, with the ability to

terminate the lease in eight years with six months notice prior to the effective date of termination to us. The tenant also has two options to extend the lease for additional periods of five years each. The lease provides for annual rents of approximately $240,000 through 2006, with prescribed escalations thereafter.

On July 7, 2005, we acquired a 30,268 square foot office building in Eatontown, New Jersey for $5.6 million, including transaction costs, and the purchase was funded using borrowings from our line of credit. Upon acquisition of the property, we were assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately six years at the time of assignment, and the tenant has two options to extend the lease for additional periods of five years each. The lease provides for annual rents of approximately $507,000 through 2006, with prescribed escalations thereafter.

On July 11, 2005, we acquired a 183,000 square foot office building in Franklin Township, New Jersey for $8.2 million, including transaction costs, and the purchase was funded using borrowings from our line of credit. Upon acquisition of the property, we extended a fifteen year triple net lease with the sole tenant, and the tenant has three options to extend the lease for additional periods of five years each. The lease also has a provision whereby the tenant may purchase the property from us on or around the eleventh anniversary of the purchase date for $9.1 million. The lease provides for annual rents of approximately $809,000 through 2006, with prescribed escalations thereafter.

On July 14, 2005, we acquired a 278,020 square foot office building in Duncan, South Carolina for $19.2 million, including transaction costs, and the purchase was funded using borrowings from our line of credit. Upon acquisition of the property, we were assigned the previously existing triple net lease with the sole tenant, which had a remaining term of approximately six years at the time of assignment, and the tenant has two options to extend the lease for additional periods of five years each. The lease provides for annual rents of approximately $1.9 million through 2006, with prescribed escalations thereafter.

On July 19, 2005 we entered into two separate long-term notes payable with the RBC Life Insurance Company, which are collateralized by our Canadian Properties. We borrowed $2.1 million in Canadian dollars, which translated to $1.7 million in US Dollars as of July 19, 2005, and the loan is collateralized by a security interest in our Montreal, Quebec property. We borrowed an additional $3.4 million in Canadian dollars, which translated to $2.8 million in US Dollars as of July 19, 2005, and the loan is collateralized by a security interest in our Granby, Quebec property. These notes both accrue interest at an interest rate of 5.22% per year. Monthly payments on the notes are based upon a twenty-five year term, with both principal and interest being paid each month. The notes mature on August 1, 2015, and we do not have the right to prepay the principal amount prior to the maturity date on either note. We used the proceeds from the notes to pay down the line of credit.

Expenses

Prior to October 1, 2004, our Adviser had an expense sharing arrangement with Gladstone Capital Advisers, a wholly-owned subsidiary of our affiliate, Gladstone Capital Corporation, through which our entire workforce was employed. Under that relationship, our Adviser reimbursed Gladstone Capital Advisers for a portion of Gladstone Capital Advisers' total payroll and benefits expenses (based on the percentage of total hours worked by Gladstone Capital Advisers' employees on our matters on an employee-by-employee basis) and a portion of Gladstone Capital Advisers' total overhead expense (based on the percentage of total hours worked by all Gladstone Capital Advisers' employees on our matters). In turn, subject to the terms and conditions of our advisory agreement, our Adviser passed these charges on to us. Effective October 1, 2004, the expense sharing arrangement with Gladstone Capital Advisers was terminated, and all of our personnel are now directly employed by our Adviser. Pursuant to the terms of our advisory agreement, we continue to be responsible for a portion of our Adviser's total payroll and benefits expenses (based on the percentage of time our Adviser's employees devote to our matters on an employee-by-employee basis) and a portion of our Adviser's total overhead expense (based on the percentage of time worked by all of our Adviser's employees on our matters). The termination of the arrangement between our Adviser and Gladstone Capital Advisers has not materially changed the level of our expenses.

During the three and six months ended June 30, 2005, payroll and benefits expenses, which are part of the management fee paid to our Adviser, were approximately $335,000 and $682,000, respectively, and during the three and six months ended June 30, 2004, payroll and benefits expenses were approximately $215,000 and $380,000, respectively. The actual amount of payroll and benefits expenses which we will be required to reimburse our Adviser in the future is not determinable, but we currently estimate that during the year ending December 31, 2005 this amount will be approximately $1.5 million. This estimate is based on our current expectations regarding our Adviser's payroll and benefits expenses and the proportion of our Adviser's time we believe will be spent on matters relating to our business. To the extent that our Adviser's payroll and benefits expenses are greater than we expect or our Adviser allocates a greater percentage of its time to our business, our actual reimbursement of our Adviser for our share of its payroll and benefits expenses could be materially greater than we currently project.

We compensate our Adviser through reimbursement of our portion of our Adviser's payroll, benefits and general overhead expenses. This reimbursement is generally subject to a combined annual management fee limitation of 2.0% of our average invested assets for the year, with certain exceptions. Reimbursement for overhead expenses is only required up to the point that reimbursed overhead expenses and payroll and benefits expenses, on a combined basis, equal 2.0% of our average invested assets for the year, and general overhead expenses are required to be reimbursed only if the amount of payroll and benefits reimbursed to our Adviser is less than 2.0% of our average invested assets for the year. However, payroll and benefits expenses are required to be reimbursed by us to the extent that they exceed the overall 2.0% annual management fee limitation. Additionally, in the event that overhead expenses exceed the combined limitation, our independent directors may authorize reimbursement of the full amount of such excess overhead expenses, or any portion thereof, if they determine that the excess expenses were justified based on unusual and nonrecurring factors which they deem sufficient. We may reimburse the Adviser only to the extent that the reimbursement would not cause our overhead expense reimbursements to exceed the 2.0% limitation in any year. To date, the advisory fee has not exceeded the annual cap.

During the three and six months ended June 30, 2005, the amount of overhead expenses that we reimbursed our Adviser was approximately $149,000 and $274,000, respectively, and during the three and six months ended June 30, 2004, the amount of overhead expenses that we reimbursed our Adviser was approximately $65,000 and $128,000, respectively. The actual amount of overhead expenses for which we will be required to reimburse our Adviser in the future is not determinable, but we currently estimate that during the year ending December 31, 2005 this amount will be approximately $600,000.

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, tax preparation, directors and officers insurance, consulting and related fees. During the three and six months ended June 30, 2005, the total amount of these expenses that we incurred was approximately $461,000 and $1,161,000, respectively. During the three and six months ended June 30, 2004, the total amount of these expenses was $306,000 and $694,000, respectively.

In addition, we are also responsible for all fees charged by third parties that are directly related to our business, which may include real estate brokerage fees, mortgage placement fees, lease-up fees and transaction structuring fees (although we may be able to pass some or all of such fees on to our tenants and borrowers). During the three and six months ended June 30, 2005 and 2004, we passed all such fees along to our tenants, and accordingly we did not incur any such fees during this time. The actual amount of such fees that we incur in the future will depend largely upon the aggregate costs of the properties we acquire, the aggregate amount of mortgage loans we make, and the extent to which we are able to shift the burden of such fees to our tenants and borrowers. Accordingly, the amount of these fees that we will pay in the future is not determinable at this time.

Critical Accounting Policies

Management believes our most critical accounting policies are revenue recognition (including straight-line rent), investment accounting, purchase price allocation, determining the risk rating of our potential tenants, accounting for our investments in real estate, provision for loans losses, the accounting for our derivative and hedging activities, if any, income taxes and stock based compensation. Each of these items involves estimates that require management to make judgments that are subjective in nature. Management relies on its experience, collects historical data and current market data, and analyzes these assumptions in order to arrive at what it believes to be reasonable estimates. Under different conditions or assumptions, materially different amounts could be reported related to the accounting policies described below. In addition, application of these accounting policies involves the exercise of judgments on the use of assumptions as to future uncertainties and, as a result, actual results could materially differ from these estimates.

Revenue Recognition

Rental revenues include rents that each tenant pays in accordance with the terms of its respective lease reported on a straight-line basis over the initial term of the lease. Because certain of our leases contain rental increases at specified intervals, straight-line basis accounting requires us to record as an asset, and include in revenues, deferred rent receivable that we will only receive if the tenant makes all rent payments required through the expiration of the initial term of the lease. Deferred rent receivable in the accompanying balance sheets represents the cumulative difference between rental revenue as recorded on a straight-line basis and rents received from the tenants in accordance with the lease terms. Accordingly, our management must determine, in its judgment, to what extent the deferred rent receivable applicable to each specific tenant is collectible. We review deferred rent receivable on a quarterly basis and take into consideration the tenant’s payment history, the financial condition of the tenant, business conditions in the industry in which the tenant operates and economic conditions in the area in which the property is located. In the event that the collectability of deferred rent with respect to any given tenant is in doubt, we would record an increase in our allowance for uncollectible accounts or record a direct write-off of the specific rent receivable, which would have an adverse effect on our net income for the year in which the reserve is increased or the direct write-off is recorded and would decrease our total assets and stockholders’ equity.

Investment Accounting

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

Purchase Price Allocation

We record above-market and below-market in-place lease values for owned properties based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management’s estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. We amortize the capitalized above-market lease values as a reduction of rental income over the remaining non-cancelable terms of the respective leases. We amortize the capitalized below-market lease values (presented in the accompanying balance sheet as value of assumed lease obligations) as an increase to rental income over the initial term and any fixed-rate renewal periods in the respective leases.

In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 141 “Business Combinations,” the total amount of other intangible assets acquired are further allocated to in-place lease values and customer relationship intangible values based on management’s evaluation of the specific characteristics of each tenant’s lease and our overall relationship with that respective tenant. Characteristics to be considered by management in allocating these values include the nature and extent of our existing business relationships with the tenant, growth prospects for developing new business with the tenant, the tenant’s credit quality and expectations of lease renewals (including those existing under the terms of the lease agreement), among other factors.

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

We amortize the value of in-place leases to expense over the initial term of the respective leases, which generally range from five to twenty years. The value of customer relationship intangibles are amortized to expense over the initial term and any renewal periods in the respective leases, but in no event will the amortization period for intangible assets exceed the remaining depreciable life of the building. Should a tenant terminate its lease, the unamortized portion of the in-place lease value and customer relationship intangibles would be charged to expense.

Risk Rating

In evaluating each transaction that it considers for investment, our Adviser seeks to assess the risk associated with the potential tenant or borrower. For companies that have debt that has been rated by a national credit ratings agency, our Adviser uses the rating as determined by such ratings agency. For companies that do not have publicly rated debt, our Adviser calculates and assigns to our borrowers and tenants a risk rating under our ten-point risk rating scale. Our risk rating system is designed to assess qualitative and quantitative risks associated with our prospective tenants and borrowers. We have developed our risk rating system to approximate the risk rating systems of major credit ratings agencies. While we seek to mirror the systems of these credit ratings agencies, we cannot assure you that our risk rating system provides the same risk rating for a particular tenant or borrower as a credit ratings agency would. The following chart is an estimate of the relationship of our risk rating system to the designations used by two credit ratings agencies to rate the risk of public debt securities of major companies. Because we have established our system to rate the risk associated with mortgage loans and real estate leases to private companies that are unrated by any credit ratings agency, we cannot assure you that the correlation between our system and the credit ratings set out below is accurate.

Our System	First Ratings Agency	Second Ratings Agency	Description (a)
>10	Baa2	BBB	Probability of default during the next ten years is 4% and the expected loss is 1% or less
10	Baa3	BBB-	Probability of default during the next ten years is 5% and the expected loss is 1% to 2%

Our System	First Ratings Agency	Second Ratings Agency	Description (a)
9	Ba1	BB+	Probability of default during the next ten years is 10% and the expected loss is 2% to 3%
8	Ba2	BB	Probability of default during the next ten years is 16% and the expected loss is 3% to 4%
7	Ba3	BB-	Probability of default during the next ten years is 17.8% and the expected loss is 4% to 5%
6	B1	B+	Probability of default during the next ten years is 22% and the expected loss is 5% to 6.5%
5	B2	B	Probability of default during the next ten years is 25% and the expected loss is 6.5% to 8%
4	B3	B-	Probability of default during the next ten years is 27% and the expected loss is 8% to 10%
3	Caa1	CCC+	Probability of default during the next ten years is 30% and the expected loss is 10% to 13.3%
2	Caa2	CCC	Probability of default during the next ten years is 35% and the expected loss is 13.3% to 16.7%
1	Caa3	CC	Probability of default during the next ten years is 65% and the expected loss is 16.7% to 20%
0	N/a	D	Probability of default during the next ten years is 85%, or there is a payment default, and the expected loss is greater than 20%

(a) *the default rates set forth above assume a ten year lease or mortgage loan. If the particular investment has a term other than ten years, the probability of default is adjusted to reflect the reduced risk associated with a shorter term or the increased risk associated with a longer term.*

We generally anticipate entering into transactions with tenants or borrowers that have a risk rating of at least 4 based on the above scale or, for tenants or borrowers whose debt rating is at least B3 or B-. Once we have entered into a transaction, we periodically re-evaluate the risk rating, or debt rating as applicable, of the investment for purposes of determining whether we should increase our reserves for loan losses or allowance for uncollectible rent. To date there have been no allowances for uncollectible rent or reserves for loan losses. Our board of directors may alter our risk rating system from time to time.

The following table reflects the average risk rating of our tenants and borrowers:

Rating	6/30/2005	12/31/2004
Average	8.5	7.8
Weighted Average	8.5	7.6
Highest	10.0	10.0
Lowest	6.0	6.0

Investments in Real Estate

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

We are required to make subjective assessments as to the useful lives of our properties for purposes of determining the amount of depreciation to record on an annual basis with respect to our investments in real estate. These assessments have a direct impact on our net income because, if we were to shorten the expected useful lives of our investments in real estate, we would depreciate these investments over fewer years, resulting in more depreciation expense and lower net income on an annual basis.

We have adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which establishes a single accounting model for the impairment or disposal of long-lived assets including discontinued operations. SFAS No. 144 requires that the operations related to properties that have been sold or that we intend to sell be presented as discontinued operations in the statement of operations for all periods presented, and properties we intend to sell be designated as "held for sale" on our balance sheet.

When circumstances such as adverse market conditions indicate a possible impairment of the value of a property, we review the recoverability of the property's carrying value. The review of recoverability is based on our estimate of the future undiscounted cash flows, excluding interest charges, expected to result from the property's use and eventual disposition. Our forecast of these cash flows considers factors such as expected future operating income, market and other applicable trends and residual value, as well as the effects of leasing demand, competition and other factors. If impairment exists due to the inability to recover the carrying value of a property, an impairment loss is recorded to the extent that the carrying value exceeds the estimated fair value of the property. We are required to make subjective assessments as to whether there are impairments in the values of our investments in real estate.

Provision for Loan Losses

Our accounting policies require that we reflect in our financial statements an allowance for estimated credit losses with respect to mortgage loans we have made based upon our evaluation of known and inherent risks associated with our private lending assets. We have extended two mortgage loans and have not experienced any actual losses in connection with our lending investments. Management reflects provisions for loan losses on a portfolio basis based upon our assessment of general market conditions, our internal risk management policies and credit risk rating system, industry loss experience, our assessment of the likelihood of delinquencies or defaults, and the value of the collateral underlying our investments. Actual losses, if any, could ultimately differ from these estimates.

Accounting for Derivative Financial Investments and Hedging Activities

We will account for our derivative and hedging activities, if any, using SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 133, an amendment of FASB Statement No. 133" and SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," which requires all derivative instruments to be carried at fair value on the balance sheet.

Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows, or other types of forecasted transactions, will be considered cash flow hedges. We will formally document all relationships between hedging instruments and hedged items, as well as our risk-management objective and strategy for undertaking each hedge transaction. We will periodically review the effectiveness of each hedging transaction, which involves estimating future cash flows. Cash flow hedges will be accounted for by recording the fair value of the derivative instrument on the balance sheet as either an asset or liability, with a corresponding amount recorded in other comprehensive income within stockholders' equity. Amounts will be reclassified from other comprehensive income to the income

statement in the period or periods the hedged forecasted transaction affects earnings. Derivative instruments designated in a hedge relationship to mitigate exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, will be considered fair value hedges under SFAS No. 133. As of June 30, 2005, we were not a party to any separate derivatives contract. Certain of our leases and loans contain embedded derivatives, principally LIBOR floors, which do not require separate accounting.

Income Taxes

Our financial results generally do not reflect provisions for current or deferred income taxes. Management believes that we have operated and will operate in a manner that will allow us to qualify as a REIT and, as a result, we do not expect to pay substantial corporate-level income taxes. Many of the requirements for REIT qualification, however, are highly technical and complex. If we were to fail to meet these requirements, we would be subject to federal income tax which could have a material adverse impact on our results of operations and amounts available for distributions to our stockholders.

Stock Based Compensation

We currently apply the intrinsic value method to account for the issuance of stock options under our 2003 Equity Incentive Plan in accordance with APB Opinion No. 25, "*Accounting for Stock Issued to Employees,*" where appropriate. In this regard, the substantial portion of these options were granted to individuals who are our officers and who qualify as leased employees under FASB Interpretation No. 44, "*Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB Opinion No. 25.*" Accordingly, because the grants were at exercise prices equal to the fair value of the stock at date of grant, we did not record any expense related to the issuance of these options under the intrinsic value method. We will adopt SFAS No. 123(R), "Share-Based Payment" effective January 1, 2006, which will require us to begin expensing stock options as compensation cost. Dependent upon the method chosen by our management for implementation of SFAS No. 123(R), prior periods may need to be adjusted.

Results of Operations

A comparison of our operating results for the three and six months ended June 30, 2005 and 2004 is below:

	For the three months ended				For the six months ended			
	June 30, 2005	June 30, 2004	$ Change	% Change	June 30, 2005	June 30, 2004	$ Change	% Change
OPERATING REVENUES								
Rental income	$2,235,241	$403,690	$1,831,551	454%	$4,082,248	$ 601,463	$3,480,785	579%
Interest income from mortgage note receivable	501,645	278,980	222,665	80%	797,228	412,400	384,828	93%
Tenant recovery revenue	39,557	—	39,557	100%	41,600	—	41,600	100%
Total operating revenues	2,776,443	682,670	2,093,773	307%	4,921,076	1,013,863	3,907,213	385%
OPERATING EXPENSES								
Depreciation and amortization	696,976	126,772	570,204	450%	1,234,731	206,101	1,028,630	499%
Management advisory fee	483,794	280,122	203,672	73%	955,655	509,538	446,117	88%
Professional fees	16,759	66,973	(50,214)	-75%	348,003	275,430	72,573	26%
Taxes and licenses	25,441	2,250	23,191	1031%	153,714	12,570	141,144	1123%
Insurance	67,021	64,488	2,533	4%	137,404	128,975	8,429	7%
Interest	254,803	—	254,803	100%	291,022	—	291,022	100%
General and administrative	97,836	172,313	(74,477)	-43%	230,664	277,263	(46,599)	-17%
Total operating expenses	1,642,630	712,918	929,712	130%	3,351,193	1,409,877	1,941,316	138%
Income (loss) from operations	1,133,813	(30,248)	1,164,061	N/M (1)	1,569,883	(396,014)	1,965,897	N/M (1)
Interest income from temporary investments	13,192	162,523	(149,331)	-92%	107,713	334,985	(227,272)	-68%
Interest income — employee loans	5,236	—	5,236	100%	9,921	—	9,921	100%
Loss on foreign currency translation	(2,710)	—	(2,710)	100%	(2,802)	—	(2,802)	100%
Other income	15,718	162,523	(146,805)	-90%	114,832	334,985	(220,153)	-66%
NET INCOME (LOSS)	$1,149,531	$132,275	$1,017,256	769%	$1,684,715	$ (61,029)	$1,745,744	N/M (1)

(1) Percentage change period over period is not meaningful because of the loss in 2004.

Comparison of the three months ended June 30, 2005 to the three months ended June 30, 2004

Revenues

For the three months ended June 30, 2005, we earned $2,235,241 of rental revenue as compared to $403,690 for the three months ended June 30, 2004. The increase of $1,831,551 or 454%, in rental revenue is primarily due to the acquisition of fourteen properties between June 30, 2004 and June 30, 2005.

Interest income from mortgage loans increased to $501,645 for the three months ended June 30, 2005 as compared to $278,980 for the three months ended June 30, 2004. The increase of $222,665, or 80%, is a result of the issuance of the additional mortgage loan on the McLean, Virginia property in April of 2005.

For the three months ended June 30, 2005, we earned $39,557 of tenant recovery revenue. This tenant recovery revenue resulted from $33,000 of franchise taxes we paid that were recovered for the 2004 tax year from the tenant of our Mt. Pocono, Pennsylvania property, and those taxes that will be recovered for the 2005 tax year from the tenant of our Canton, North Carolina property. It also includes a portion of the management fee reimbursed by the tenant in our Akron, Ohio property.

Expenses

Depreciation and amortization expenses of $696,976 were recorded for the three months ended June 30, 2005, as compared to $126,772 for the three months ended June 30, 2004. The increase of $570,204, or 450%, is a direct result of the increased number of acquisitions completed between June 30, 2004 and June 30, 2005.

The management advisory fee for the three months ended June 30, 2005 increased to $483,794, as compared to $280,122 for the three months ended June 30, 2004. The increase of $203,672, or 73%, is primarily a result of the increased time that our Adviser's employees spent on our company matters. The management advisory fee consists of the reimbursement of expenses, including direct allocation of employee salaries and benefits, as well as general overhead expense, to our Adviser in accordance with the terms of the advisory agreement.

Professional fees, consisting primarily of legal and accounting fees, were $16,759 for the three months ended June 30, 2005, as compared to $66,973 for the three months ended June 30, 2004. The decrease of $50,214, or 75%, was primarily a result of $100,000 of legal fees that were accrued and expensed in the quarter ended March 31, 2005 that were subsequently capitalized on the balance sheet as a cost of the line of credit. This was a one time non-recurring event during the quarter ended June 30, 2005 and without this reversal, legal and accounting fees would have been approximately $116,000 for the second quarter of 2005. Excluding the reversal of legal fees, professional fees increased $65,786, or 98%, as compared to the three months ended June 30, 2004. This increase was a result of increased professional fees for the audit of the financial statements, coupled with increased legal fees incurred from the increased portfolio of investments.

Taxes and licenses for the three months ended June 30, 2005 were $25,441, an increase of $23,191, or 1,031%, from $2,250 for the three months ended June 30, 2004. This increase is primarily attributable to franchise taxes for doing business in certain states of approximately $18,000, which were accrued in the second quarter of 2005.

Insurance expense increased to $67,021 for the three months ended June 30, 2005, as compared to $64,488 for the three months June 30, 2004. The increase of $2,533, or 4%, is a result of an increase in insurance premiums year over year.

Interest expense was $254,803 for the three months ended June 30, 2005. This amount consisted of $26,023 in unused line of credit fees on the line of credit obtained in February of 2005, $119,854 in interest expense from borrowings against the line of credit, $50,336 of interest expense on the mortgage note

payable issued in March of 2005, and $58,590 of deferred financing fees from the line of credit. There was no interest expense incurred for the three months ended June 30, 2004.

General and administrative expenses were $97,836 for the three months ended June 30, 2005, as compared to $172,313 and consisted mainly of directors' fees, stockholder-related expenses, and recruiting expense. The decrease of $74,477, or 43%, was primarily a result of $40,000 of recruiting expense paid in the second quarter of 2004, coupled with a decrease in stockholder-related expenses year over year as a result of higher printing costs in 2004 for the annual report.

Because we have only recently begun our operations, we do not believe that our current level of operating expenses relative to revenues is indicative of our operating expenses in the future. As we continue to expand our real estate investments, we expect our revenues and operating expenses to increase and that ultimately our annual management advisory fee will be approximately 2% of our invested assets.

Interest Income

Interest income on cash and cash equivalents decreased during the three months ended June 30, 2005 to $13,192, as compared to $162,523 for the three months ended June 30, 2004. The decrease of $149,331, or 92%, is primarily a result of the increase in our portfolio of investments in real estate and mortgage loans, resulting in lower average cash balances invested. This interest represents the interest earned on the investment of the net proceeds from our initial public offering in short-term investment grade securities, primarily U.S. Treasury Bills.

During the three months ended June 30, 2005, we earned interest income on employee loans of $5,236. This interest represents the interest earned on loans extended to employees in connection with the exercise of their stock options.

Foreign Currency Loss

Foreign currency translation loss during the three months ended June 30, 2005 was $2,710, which represents the loss in connection with the translation of monthly rental payments denominated in a foreign currency, and the valuation of certain balance sheet items denominated in a foreign currency at the end of each quarter. There was no foreign currency loss during the three months ended June 30, 2004.

Net Income

For the three months ended June 30, 2005, we recorded net income of $1,149,531, as compared to $132,275 for the three months ended June 30, 2004. This increase of $1,017,256, is primarily a result of the increase in our portfolio of investments in the past year and the other events described above. Based on the basic and diluted weighted average common shares outstanding of 7,669,802 and 7,692,639, respectively, for the three months ended June 30, 2005, the basic and diluted earnings per weighted average common share were both $0.15. Based on the basic and diluted weighted average common shares outstanding of 7,642,000 and 7,695,134, respectively, for the three months ended June 30, 2004, the basic and diluted earnings per weighted average common share were both $0.02.

Comparison of the six months ended June 30, 2005 to the six months ended June 30, 2004

Revenues

For the six months ended June 30, 2005, we earned $4,082,248 of rental revenue as compared to $601,463 for the six months ended June 30, 2004. The increase of $3,480,785, or 579%, in rental revenue is primarily due to the acquisition of fourteen properties between June 30, 2004 and June 30, 2005.

Interest income from the mortgage loans increased to $797,228 for the six months ended June 30, 2005 as compared to $412,400 for the six months ended June 30, 2004. The increase of $384,828, or 93%, is due to the fact that a mortgage loan was originated during the first quarter of 2004, and interest was only

earned on this loan for a portion of the six months ended June 30, 2004, and that we also issued an additional mortgage loan in April of 2005.

For the six months ended June 30, 2005, we earned $41,600 of tenant recovery revenue. This tenant recovery revenue resulted from $33,000 of franchise taxes we paid that were recovered for the 2004 tax year from the tenant of our Mt. Pocono, Pennsylvania property, and those taxes that will be recovered for the 2005 tax year from the tenant of our Canton, North Carolina property. It also includes a portion of the management fee reimbursed by the tenant in our Akron, Ohio property.

Expenses

Depreciation and amortization expenses of $1,234,731 were recorded for the six months ended June 30, 2005, as compared to $206,101 for the six months ended June 30, 2004. The increase of $1,028,630, or 499%, is primarily a result of the number of acquisitions completed between June 30, 2004 and June 30, 2005.

The management advisory fee for the six months ended June 30, 2005 increased to $955,655, as compared to $509,538 for the six months ended June 30, 2004. The increase of $446,117, or 88%, is primarily a result of the increased time that our Adviser's employees spent on our company matters. The management advisory fee consists of the reimbursement of expenses, including direct allocation of employee salaries and benefits, as well as general overhead expense, to our Adviser in accordance with the terms of the advisory agreement.

Professional fees, consisting primarily of legal and accounting fees, were $348,003 for the six months ended June 30, 2005, as compared to $275,430 for the six months ended June 30, 2004. The increase of $72,573, or 26%, was primarily a result of the increased accounting fees related to the audit of our internal controls performed in order to comply with the Sarbanes–Oxley Act of 2002.

Taxes and licenses for the six months ended June 30, 2005 were $153,714, an increase of $141,144, or 1,123%, from $12,570 for the six months ended June 30, 2004. This increase is primarily attributable to the payment of $138,000 of franchise taxes paid for doing business in certain states. Approximately $100,000 of these franchise taxes relate to taxes incurred in 2004, however management has determined that these expenses were immaterial to the 2004 earnings, and were subsequently expensed in the quarter ending March 31, 2005. We expect to reduce future incurrence of these types of taxes next year by restructuring our entities in these specific states, however we can not provide assurance that this restructuring will reduce the taxes in all states.

Insurance expense increased to $137,404 for the six months ended June 30, 2005, as compared to $128,975 for the six months June 30, 2004. The increase of $8,429, or 7%, is a result of an increase in insurance premiums year over year.

Interest expense was $291,022 for the six months ended June 30, 2005. This amount consisted of $37,134 in unused line of credit fees accrued on the line of credit obtained in February of 2005, $119,854 in interest expense from borrowings against the line of credit, $59,198 of interest expense on the mortgage note payable issued in March of 2005, and $74,836 of deferred financing fees from the line of credit. There was no interest expense incurred for the six months ended June 30, 2004.

General and administrative expenses were $230,664 for the six months ended June 30, 2005, as compared to $277,263 for the six months ended June 30, 2004, and consisted mainly of directors' fees, stockholder-related expenses, and recruiting expense. The decrease of $46,599, or 17%, was primarily a result of $40,000 of recruiting expense paid in the second quarter of 2004, coupled with a decrease in the costs associated with printing our annual report, partially offset by increases in travel expense and management fees paid for certain of our properties.

Because we have only recently begun our operations, we do not believe that our current level of operating expenses relative to revenues is indicative of our operating expenses in the future. As we

continue to expand our real estate investments, we expect our revenues and operating expenses to increase and that ultimately our annual management advisory fee will be approximately 2% of our invested assets.

Interest Income

Interest income on cash and cash equivalents decreased during the six months ended June 30, 2005 to $107,713, as compared to $334,985 for the six months ended June 30, 2004. The decrease of $227,272, or 68%, is primarily a result of the increase in our portfolio of investments in real estate and mortgage loans, resulting in lower average cash balances invested. This interest represents the interest earned on the investment of the net proceeds from our initial public offering in short-term investment grade securities, primarily U.S. Treasury Bills.

During the six months ended June 30, 2005, we earned interest income on employee loans of $9,921. This interest represents the interest earned on loans extended to employees in connection with the exercise of their stock options.

Foreign Currency Loss

Foreign currency translation loss during the six months ended June 30, 2005 was $2,802, which represents the loss in connection with the translation of monthly rental payments denominated in a foreign currency, and the valuation of certain balance sheet items denominated in a foreign currency at the end of each quarter. There was no foreign currency loss during the six months ended June 30, 2004.

Net Income

For the six months ended June 30, 2005, we recorded net income of $1,684,715, as compared to a net loss of $61,029 for the six months ended June 30, 2004. This increase of $1,745,744, is primarily a result of the increase in our portfolio of investments in the past year and the other events described above. Based on the basic and diluted weighted average common shares outstanding of 7,668,409 and 7,715,100, respectively, for the six months ended June 30, 2005, the basic and diluted earnings per weighted average common share were both $0.22. Based on the basic and diluted weighted average common shares outstanding of 7,642,000 and 7,764,732, respectively, for the six months ended June 30, 2004, the basic and diluted loss per weighted average common share were both $0.01.

Liquidity and Capital Resources

Cash and Cash Equivalents

At June 30, 2005, we had approximately $216,000 in cash and cash equivalents, a decrease of $28.9 million from $29.2 million at December 31, 2004. We have fully invested the proceeds from our initial public offering, and have access to our existing line of credit and have obtained mortgages on three of our properties. We expect to obtain additional mortgages secured by some or all of our real property in the future in order to have the cash on hand to make additional investments and fund our continuing operations.

Operating Activities

Net cash provided by operating activities during the six months ended June 30, 2005 was approximately $2.7 million, consisting primarily of net income, amortization of deferred financing costs and deferred rent asset, decreases in other assets and prepaid expenses, increases in accounts payable and accrued expenses, partially offset by decreases in rent received in advance and security deposits, increases in mortgage interest receivable, and increases in deferred rent receivable.

Net cash provided by operating activities during the six months ended June 30, 2004 was $357,408, consisting primarily of a decrease in prepaid assets, increases in rent received in advance and security

deposits and an increase in accrued expenses and accounts payable, partially offset by a decrease in amounts due our adviser and an increase in mortgage interest receivable.

Investing Activities

Net cash used in investing activities during the six months ended June 30, 2005 was $51.6 million, which consisted of our purchases of the San Antonio, Texas flexible office building, and the Columbus, Ohio industrial building, both purchased in February of 2005, the Big Flats, New York building, purchased in April of 2005, the Wichita, Kansas office building and the Arlington, Texas warehouse and bakery both purchased in May of 2005, the Dayton, Ohio office building purchased in June of 2005, the extension of a mortgage loan on the Mclean, Virginia property, and deposits placed on future acquisitions, partially offset by principal repayments from our mortgage note receivable on the Sterling Heights, Michigan property.

Net cash used in investing activities during the six months ended June 30, 2004 was $33.4 million, which consisted of our purchase of the Canton, Ohio commercial office and warehouse property in January 2004, the Akron, Ohio commercial office and laboratory space in April 2004, the Charlotte, North Carolina commercial office space in June 2004 and our extension of a mortgage loan on the Sterling Heights, Michigan commercial property in February 2004.

Financing Activities

Net cash provided by financing activities for the six months ended June 30, 2005 was approximately $20.0 million. This amount consisted of the proceeds received from the long-term financing of our Canton, North Carolina property, the proceeds from borrowings under our line of credit, and principal repayments on employee loans, partially offset by principal repayments on the mortgage note payable, dividend payments to our stockholders, and financing costs paid in connection with our line of credit and mortgage note payable on the Canton, North Carolina property.

Net cash used in financing activities for the six months ended June 30, 2004 was approximately $1.0 million. This amount consisted primarily of dividend payments to our stockholders.

Future Capital Needs

We had purchase commitments for four properties at June 30, 2005 in the aggregate amount of $36.1 million, where a deposit had been placed on the real estate as of June 30, 2005. Subsequent to June 30, 2005, we made three investments in the aggregate amount of $33.0 million.

As of August 2, 2005, we have invested all of the net proceeds from our initial public offering in real properties and mortgage loans. As of June 30, 2005, we have investments in eighteen real properties for $105.7 million and two mortgage loans for approximately $21.2 million. Subsequent to June 30, 2005, we made three investments in the aggregate amount of $33.0 million. During the remainder of 2005 and beyond, we expect to complete additional acquisitions of real estate and to extend additional mortgage notes. The net proceeds of our initial public offering have been fully invested, and we intend to acquire additional properties by borrowing all or a portion of the purchase price and collateralizing the loan with mortgages secured by some or all of our real property, or by borrowing against our existing line of credit. We may also use borrowings from our line of credit for general corporate needs. If we are unable to make any required debt payments on any borrowings we make in the future, our lenders could foreclose on the properties collateralizing their loans, which could cause us to lose part or all of our investments in such properties. We also may issue additional equity securities in the future to finance future investment although there can be no assurance that we would be able to do so on favorable terms if at all.

Line of Credit

On February 28, 2005 we entered into a line of credit agreement with a syndicate of banks led by Branch Banking & Trust Company. This line of credit initially provided us with up to $50 million of financing, with an option to increase the line of credit up to a maximum of $75 million upon agreement of the syndicate of banks. The line of credit matures on February 28, 2008. The interest rate charged on the advances under the facility is based on LIBOR, the prime rate or the federal funds rate, depending on market conditions, and adjusts periodically. The unused portion of the line of credit is subject to a fee of 0.25% per year. Our ability to access this funding source is subject to our continuing to meet customary lending requirements such as compliance with financial and operating covenants and meeting certain lending limits, as of June 30, 2005 we are in compliance with all financial and operating covenants For example, as is customary with such line of credit facilities, the maximum amount we may draw under this agreement is based on the percentage of the value of our properties meeting agreed-upon eligibility standards that we have pledged as collateral to the banks. As we arrange for long-term mortgages for these properties, the banks will release the properties from the line of credit and reduce the availability under the line of credit by the advanced amount of the removed property. Conversely, as we purchase new properties meeting the eligibility standards, we may pledge these new properties to obtain additional advances under this agreement . We may use the advances under the line of credit for both general corporate purposes and the acquisition of new investments.

On July 6, 2005, we amended the line of credit to increase the maximum availability under the line from $50 million to $60 million. As of August 1, 2005, we may draw up to an aggregate of $58.3 million under this agreement, of which we have aggregate borrowings outstanding under the line of credit of $49.4 million .

Mortgage Notes Payable

On March 16, 2005 we borrowed $3,150,000 pursuant to a long-term note payable from Key Bank National Association, which is collateralized by a security interest in our Canton, North Carolina property. The note accrues interest at an initial interest rate of 6.33% per year until the anticipated repayment date of April 1, 2010. Monthly payments on the note are based upon a twenty-five year term, with both principal and interest being paid each month. If the note is not repaid before the anticipated repayment date, interest will accrue on the remaining outstanding principal balance from and after the anticipated repayment date at the greater of the initial interest rate plus 2%, or the treasury rate for the week ending prior to the anticipated repayment date plus 2%. We may repay this note at any time after June 23, 2009 and not be subject to a prepayment penalty. The note matures on April 1, 2030, however we expect to repay the note in full prior to the anticipated repayment date. We used the proceeds from the note to acquire additional investments for our portfolio.

On July 19, 2005 we entered into two separate long-term notes payable with the RBC Life Insurance Company, which are collateralized by our Canadian Properties. We borrowed $2.1 million in Canadian dollars, which translated to $1.7 million in US Dollars as of July 19, 2005, and the loan is collateralized by a security interest in our Montreal, Quebec property. We borrowed an additional $3.4 million in Canadian dollars, which translated to $2.8 million in US Dollars as of July 19, 2005, and the loan is collateralized by a security interest in our Granby, Quebec property. These notes both accrue interest at an interest rate of 5.22% per year. Monthly payments on the notes are based upon a twenty-five year term, with both principal and interest being paid each month. The notes mature on August 1, 2015, and we do not have the right to prepay the principal amount prior to the maturity date on either note. We used the proceeds from the notes to pay down the line of credit.

Contractual Obligations

The following table reflects our significant contractual obligations as of June 30, 2005:

		Payments Due by Period			
Contractual Obligations	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-Term Debt Obligations	3,150,000	51,055	111,923	127,744	2,859,278
Capital Lease Obligations	—	—	—	—	—
Operating Lease Obligations(1)	—	—	—	—	—
Purchase Obligations(2)	36,100,000	36,100,000	—	—	—
Other Long-Term Liabilities Reflected on the Registrant's Balance Sheet under GAAP	—	—	—	—	—
Total	$39,250,000	$ 36,151,055	$111,923	$127,744	$2,859,278

(1) This does not include the portion of the operating lease on office space that is allocated to us by our Adviser in connection with our advisory agreement.

(2) The purchase obligations reflected in the above table represents commitments outstanding at June 30, 2005 to purchase real estate, $33.0 million of which were subsequently closed in July of 2005.

Funds from Operations

The National Association of Real Estate Investment Trusts (NAREIT) developed Funds from Operations ("FFO"), as a relative non-GAAP (Generally Accepted Accounting Principles in the United States) supplemental measure of operating performance of an equity REIT in order to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. FFO, as defined by NAREIT, is net income (loss) (computed in accordance with GAAP), excluding gains (or losses) from sales of property, plus depreciation and amortization of real estate assets, and after adjustments for unconsolidated partnerships and joint ventures.

FFO does not represent cash flows from operating activities in accordance with GAAP (which, unlike FFO, generally reflects all cash effects of transactions and other events in the determination of net income (loss)) and should not be considered an alternative to 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. Comparison of FFO, using the NAREIT definition, to similarly titled measures for other REITs may not necessarily be meaningful due to possible differences in the application of the NAREIT definition used by such REITs.

Diluted funds from operations per share ("Diluted FFO per share") is FFO divided by weighted average common shares outstanding on a diluted basis during a period. We believe that FFO 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 ("EPS") in evaluating net income available to common shareholders. In addition, since most REITs provide FFO and Diluted FFO per share information to the investment community, we believe FFO and Diluted FFO per share are useful supplemental measures for comparing us to other REITs. We believe that net income is the most directly comparable GAAP measure to FFO 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 three and six months ended June 30, 2005 and 2004 to the most directly comparable GAAP measure, net income, and a computation of diluted FFO per weighed average common share and diluted net income per weighted average common share:

	For the three months ended June 30, 2005	For the three months ended June 30, 2004	For the six months ended June 30, 2005	For the six months ended June 30, 2004
Net income (loss)	$1,149,531	$ 132,275	$1,684,715	$ (61,029)
Real estate depreciation and amortization	696,976	126,772	1,234,731	206,101
Funds from operations	1,846,507	259,047	2,919,446	145,072
Weighted average shares outstanding — diluted	7,692,639	7,695,134	7,715,100	7,764,732
Diluted net income (loss) per weighted average common share	$ 0.15	$ 0.02	$ 0.22	$ (0.01)
Diluted funds from operations per weighted average common share	$ 0.24	$ 0.03	$ 0.38	$ 0.02

Item 3. Quantitative and Qualitative Disclosure 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 will be exposed to is interest rate risk. We currently have two variable rate loans, certain of our leases contain escalations based on market interest rates, and the interest rate on our existing line of credit is variable. We seek to mitigate this risk by structuring such provisions to contain a minimum interest rate or escalation rate, as applicable. We are also exposed to the effects of interest rate changes as a result of the holding of our cash and cash equivalents in short-term, interest-bearing investments.

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

Under this analysis, a hypothetical increase in the one month LIBOR rate by 1% would increase our interest and rental revenue by $102,000 and increase our interest expense on the line of credit by $220,000 for a net decrease in our net income of approximately $118,000, or 3.5%, over the next twelve months, compared to net income for the latest twelve months ended June 30, 2005. A hypothetical decrease in the one month LIBOR by 1% would decrease our interest and rental revenue by $100,000 and decrease our interest expense on the line of credit by $220,000 for a net increase in our net income of approximately $120,000, or 3.5%, over the next twelve months, compared to net income for the latest twelve months ended June 30, 2005. Although management believes that this analysis is indicative of our existing interest rate sensitivity, it does not adjust for potential changes in credit quality, size and composition of our loan and lease portfolio on the balance sheet and other business developments that could affect net income. Accordingly, no assurances can be given that actual results would not differ materially from the results under this hypothetical analysis.

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

We have purchased two properties in Canada, and the monthly rental payments on these properties are received in Canadian dollars. In order to mitigate the risk of foreign currency rate fluctuations, we have secured loans on the real estate properties in which the mortgage payments are denominated in Canadian dollars. While we have minimized the exchange rate risk, we are still exposed to fluctuations in the exchange rate, as we have to convert the payments into US dollars at each transaction date. Exchange rate movements to date have not had a significant effect on our financial position or results of operations. For the six months ended June 30, 2005, we had a $2,802 foreign currency transaction loss in connection with the translation of monthly rental payments denominated in a foreign currency.

To illustrate the potential impact of changes in exchange rates on our net income, we have performed the following analysis, which assumes that our balance sheet remains constant and no further actions beyond a minimum exchange rate fluctuation are taken to alter our existing foreign currency sensitivity.

Under this analysis, a hypothetical increase (or decrease) in the value of the Canadian dollar to the US dollar by 10% would increase (or decrease) our net income by approximately $60,000 or 1.8% over the next twelve months, compared to net income for the latest twelve months ended June 30, 2005. Although

management believes that this analysis is indicative of our existing exchange rate sensitivity, no assurances can be given that actual results would not differ materially from the results under this hypothetical analysis.

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, all of which may affect our ability to refinance debt if necessary.

Item 4. Controls and Procedures

a) Evaluation of Disclosure Controls and Procedures

As of June 30, 2005, our management, including the chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, management, including the chief executive officer and chief financial officer, concluded that the disclosure controls and procedures were effective in timely alerting management of material information about the company required to be included in our periodic Securities and Exchange Commission filings. However, while evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply judgment in evaluating the cost-benefit relationship of possible controls and procedures.

b) Changes in Internal Control over Financial Reporting

There were no changes in internal controls for the period ended June 30, 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

Neither we nor any of our subsidiaries are currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us or our subsidiaries.

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

As of June 30, 2005, we had invested all of the net proceeds from our initial public offering in eighteen real properties and two mortgage loans. As of June 30, 2005, we had used approximately $5.0 million in our operating activities, of which approximately $2.5 million has been paid to our Adviser (which is an affiliate of ours) in partial payment of amounts owed under our advisory agreement.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Stockholders was held on May 25, 2005. The stockholders voted and approved the following matter:

- The election of two Class I directors to hold office until the 2008 Annual Meeting of Stockholders.

Nominee	Shares Voted For	Authority Withheld
Michela English	7,366,497	11,249
Anthony Parker	7,366,112	11,634

Item 5. Other Information

Not applicable.

Item 6. Exhibits

Exhibit Index

Exhibit	Description of Document
3.1†	Amended and Restated Articles of Incorporation, incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-11 (File No. 333-106024), filed June 11, 2003.
3.2†	Bylaws, incorporated by reference to Exhibit 3.2 to the Registration Statement on Form S-11 (File No. 333-106024), filed June 11, 2003.
10.2†	First Amendment to Credit Agreement and Waiver by and among Gladstone Commercial Corporation, Gladstone Commercial Limited Partnership, Branch Banking and Trust Company and certain other parties, dated as of April 21, 2005, incorporated by reference to Exhibit 10.2 of the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2005, filed on May 4, 2005.
10.3	Second Amendment to Credit Agreement and Loan Documents by and among Gladstone Commercial Corporation, Gladstone Commercial Limited Partnership, Branch Banking and Trust Company, and certain other parties, dated as of July 6, 2005.
11	Computation of Per Share Increase in Stockholders' Equity from Operations (included in the notes to the unaudited financial statements contained in this report).

Exhibit	Description of Document
31.1	Certification of Chief Executive Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.

† Previously filed and incorporated by reference.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Gladstone Commercial Corporation

Date: August 2, 2005

By: /s/ Harry Brill

Harry Brill
Chief Financial Officer and Treasurer

Exhibit Index

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† Previously filed and incorporated by reference.

Exhibit 10.3

SECOND AMENDMENT TO CREDIT AGREEMENT AND LOAN DOCUMENTS

THIS SECOND AMENDMENT TO CREDIT AGREEMENT AND LOAN DOCUMENTS (this “Amendment”) is made as of the 6th day of July, 2005, by and among GLADSTONE COMMERCIAL CORPORATION and GLADSTONE COMMERCIAL LIMITED PARTNERSHIP, as Borrowers (together, the “Borrowers”), the GUARANTORS signatory hereto, as guarantors (collectively, the “Guarantors”), and BRANCH BANKING AND TRUST COMPANY, as Administrative Agent (the “Administrative Agent”) and a Bank, FIRST HORIZON BANK, as a Bank, and COMPASS BANK, as a Bank (collectively, the “Banks”).

RECITALS:

The Borrowers, the Guarantors, the Administrative Agent and the Banks have entered into a certain Credit Agreement dated as of February 28, 2005, as amended by the First Amendment to Credit Agreement and Waiver dated as of April 21, 2005 (as so amended, the “Credit Agreement”). Capitalized terms used in this Amendment which are not otherwise defined in this Amendment shall have the respective meanings assigned to them in the Credit Agreement.

The Borrowers have requested the Administrative Agent and the Banks to further amend the Credit Agreement, the Notes and the Loan Documents to modify certain provisions thereof (i) to exercise the “accordion” to increase the aggregate Commitments from $50,000,000 to $60,000,000, (ii) to consolidate certain of the Loan Documents deliverable in connection with the addition of new Collateral and the joinder of new Guarantors to simplify document deliveries for new Collateral closings and (iii) to permit Mortgages and related local counsel opinions for new Collateral to be delivered up to 45 days following the closing with respect to the new Collateral and the increase of the Borrowing Base related thereto (subject to a 20% Borrowing Base sublimit on such undelivered mortgages and opinions), all as more fully set forth herein. The Administrative Agent, the Banks, the Borrowers and the Guarantors desire to amend the Credit Agreement, the Notes and certain other Loan Documents upon the terms and conditions hereinafter set forth.

NOW, THEREFORE, in consideration of the Recitals and the mutual promises contained herein and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Borrowers, the Guarantors, the Administrative Agent and the Banks, intending to be legally bound hereby, agree as follows:

SECTION 1. Recitals. The Recitals are incorporated herein by reference and shall be deemed to be a part of this Amendment.

SECTION 2. Increase in Commitments; New Notes. Pursuant to Section 2.01(b) of the Credit Agreement, the total Commitments are hereby increased from $50,000,000 to $60,000,000. The new Commitment of each Bank shall be as set forth opposite the name of such Bank on the signature pages hereof and the Borrowers shall execute and deliver new Notes identical to the existing Notes but reflecting such increased Commitments and the Banks shall return the existing Notes to the Company for cancellation.

SECTION 3. Amendments. The Credit Agreement is hereby amended as set forth in this Section 3.

SECTION 3.01. Addition to Section 1.01. Section 1.01 of the Credit Agreement is amended by:

(a) adding the following new definition of "Addition of New Collateral Agreement":

"Addition of New Collateral Agreement" means one or more Addition of New Collateral Agreements in substantially the form of Exhibit S hereto executed and delivered by the Loan Parties pursuant to Section 2.14(b) and 5.25 hereof.

(b) amending and restating the definitions of "Borrowing Base", "Borrowing Base Asset", "Borrowing Base Certification Report", "Borrowing Base Value", "Collateral Documents" and "Membership Pledge Agreement" to read in their entirety as follows:

"Borrowing Base" shall mean, based on the most recent Borrowing Base Certification Report which as of the date of a determination of the Borrowing Base has been received by the Administrative Agent, an amount equal to 65% of the sum of the Borrowing Base Values of the Borrowing Base Assets as determined and adjusted from time to time in accordance with Section 2.14; provided that: (1) to the extent (x) the sum of the Borrowing Base Values for all Mortgaged Properties included in the Borrowing Base as Borrowing Base Assets for which Mortgages or local counsel opinions have not yet been received by the Administrative Agent pursuant to the last sentence of Section 2.14(d) exceeds (y) 20% of the sum of the Borrowing Base Values of all Borrowing Base Assets (as (y) is determined after giving effect to the $19,230,000 limit on Mortgaged Properties contained in the definition of Borrowing Base Value but before giving effect to the 15% limit on Mortgage Receivables in clause (2) immediately below), such excess of (x) over (y) shall be excluded from the Borrowing Base and (2) to the extent that (x) the sum of the Borrowing Base Values of all Pledged Mortgage Receivables exceeds (y) 15% of the sum of the Borrowing Base Value of all Borrowing Base Assets, such excess of (x) over (y) shall be excluded from the Borrowing Base. The Administrative Agent shall also be entitled to hold and subtract any reserve against the Borrowing Base it deems reasonably necessary as security for payment of the Notes and the obligations of the Guarantors under Article X of this Agreement and the obligations of the Borrowers under the Letter of Credit Agreements.

"Borrowing Base Asset" means (i) a Mortgaged Property which is also an Eligible Property or (ii) a Pledged Mortgage Receivable which is also an Eligible Mortgage Receivable, in each case which is included in the Borrowing Base pursuant to Section 2.14. A Property, the value of which was previously included in the Borrowing Base calculation as a Borrowing Base Asset, shall cease to be a Borrowing Base Asset and shall be excluded from such Borrowing Base calculation if at any time such Property shall cease to meet all the requirements of an Eligible Property contained in the definition thereof (including without limitation time limits for inclusion as an Eligible Property) or

shall cease to be a Mortgaged Property or, if such Mortgaged Property is subject to the 45 day extension for receipt of Mortgages and local counsel opinions post-closing as provided in the last sentence of Section 2.14(d), then if either a Mortgage or local counsel opinion, in each case satisfactory to the Administrative Agent, shall fail to be delivered to the Administrative Agent during such 45 day period. A Mortgage Receivable, the value of which was previously included in the Borrowing Base calculation as a Borrowing Base Asset, shall cease to be a Borrowing Base Asset if at any time such Mortgage Receivable shall cease to meet all the requirements of an Eligible Mortgage Receivable contained in the definition thereof (including without limitation time limits for inclusion as an Eligible Mortgage Receivable) or shall cease to be a Pledged Mortgage Receivable.

"Borrowing Base Certification Report" means a report in substantially the form attached hereto as Exhibit N, and otherwise satisfactory to the Administrative Agent (or, if the Borrowers so elect and the Administrative Agent so agrees, an Excel or similar spreadsheet to substantially the same effect as Exhibit N), certified by the chief financial officer or other authorized officer of the Borrowers setting forth the calculations required to establish the Borrowing Base Value for each Borrowing Base Asset and the Borrowing Base Value for all Borrowing Base Assets as of a specified date, and, whether in Exhibit N or spreadsheet form, in form and detail satisfactory to the Administrative Agent.

"Borrowing Base Value" means, with respect to a Borrowing Base Asset for any date of determination, an amount equal to: (A) in the case of Mortgaged Properties the least of (a) the Acquisition Cost of such Borrowing Base Asset; (b) the Appraised Value of such Borrowing Base Asset (determined at the time such Borrowing Base Asset is acquired by the Eligible Property Owner or such subsequent time as the Administrative Agent or the Required Banks may reasonably request, or Borrowers may elect to provide an updated appraisal (provided that no such updated appraisal provided by Borrowers shall be effective to increase the Borrowing Base Value of any Borrowing Base Asset unless at least six months have elapsed from the date of inclusion of such Borrowing Base Asset in the Borrowing Base and the date of the updated appraisal)) and (c) $19,230,000; and (B) in the case of Pledged Mortgage Receivables the lesser of: (a) the lesser of the face amount or the principal outstanding balance of the promissory note evidencing the Pledged Mortgage Receivable; and (b) the Appraised Value of the Mortgage Receivable Property at the time of the granting of such Mortgage or such subsequent time as the Administrative Agent or the Required Banks may reasonably request, or Borrowers may elect to provide an updated appraisal (provided that no such updated appraisal provided by Borrowers shall be effective to increase the Borrowing Base Value of any Borrowing Base Asset unless at least six months have elapsed from the date of inclusion of such Borrowing Base Asset in the Borrowing Base and the date of the updated appraisal).

"Collateral Documents" means, collectively, the Membership Pledge Agreement, the Mortgages, the Mortgaged Property Security Documents, the Mortgage Receivables Pledge Agreement, the Pledged Mortgage Receivable Security Documents, the Addition of New Collateral Agreements and all other agreements (including control agreements), instruments and other documents, whether now existing or hereafter in effect, pursuant to which the Borrowers or any Subsidiary shall grant or convey to the Secured Parties a

Lien in, or any other Person shall acknowledge any such Lien in, property as security for all or any portion of the Obligations, as any of them may be amended, modified or supplemented from time to time.

"Membership Pledge Agreement" means collectively (or individually as the context may indicate): (i) a Membership Pledge Agreement by the Operating Partnership in favor of the Administrative Agent for the benefit of the Secured Parties dated the date hereof, (ii) any joinders or amendments thereto or any additional Equity Pledge Agreement (as such Membership Pledge Agreement was retitled pursuant to the First Amendment to Credit Agreement dated as of April 21, 2005) in substantially the form of Exhibit R to said First Amendment and delivered to the Administrative Agent pursuant to Section 5.25 of the Credit Agreement and (iii) any Addition of New Collateral Agreement delivered to the Administrative Agent pursuant to Section 5.25 of the Credit Agreement ."

SECTION 3.02. Amendment to Section 2.14(d) and (e). Paragraphs (d) and (e) of Section 2.14 of the Credit Agreement are amended and restated to read in their entirety as follows:

"(d) Documents with Respect to Guarantor and Property. Upon the approval of a Property or Mortgage Receivable as a Borrowing Base Asset, the Borrowers shall deliver to the Administrative Agent, to the extent not previously delivered to the Administrative Agent, the items that would have been delivered with respect to such Property or Mortgage Receivable and such Guarantor under Sections 5.25 and 3.01(c), (e), (g), (h) and (l) as if such Guarantor had been a Guarantor and such Property or Mortgage Receivable had been a Borrowing Base Asset on the Closing Date. Until such time as the Administrative Agent shall have received the items referred to in the foregoing sentence with respect to any Guarantor or Property or Mortgage Receivable, the Borrowing Base Value of any such Borrowing Base Asset shall be $0. Notwithstanding the foregoing, the Borrowers shall have an additional 45 days following the date of the closing with respect to any addition of new Collateral hereunder to deliver any Mortgages or opinions of local counsel relating thereto, it being understood that the Borrowing Base Value of such Mortgaged Properties shall be included in the Borrowing Base during such 45 day period provided, however, if, at any time the Borrowing Base Value of all Borrowing Base Assets for which Mortgages or related opinions have not yet been delivered exceeds twenty percent (20%) of the Borrowing Base Value of all Borrowing Base Assets, then any such excess over said twenty percent shall be excluded from the Borrowing Base Value during such period.

(e) Disqualification of Borrowing Base Assets. Except as otherwise provided in the last sentence of paragraph (d) above, if at any time from or after the inclusion of a Borrowing Base Asset in the Borrowing Base, any event or occurrence, including the passage of time (and including the failure of Borrowers to deliver a Mortgage or related local counsel opinion within 45 days of inclusion of a new Mortgaged Property as a Borrowing Base Asset), causes any such Borrowing Base Asset to fail to meet the requirements of the definition of Eligible Property or Mortgaged Property, in the case of any Mortgaged Property, or Eligible Mortgage Receivable or Pledged Mortgage

Receivable, in the case of any Pledged Mortgage Receivable (including without limitation by reason of any representation or warranty contained in any Collateral Document with respect to any Borrowing Base Asset failing to continue to be true and correct), or if any Mortgage or local counsel opinion delivered pursuant to paragraph (d) above shall prove undeliverable or unsatisfactory to the Administrative Agent, then the Borrowing Base Value of such Borrowing Base Asset shall immediately be deemed $0 and the Borrowing Base shall be recalculated accordingly. Borrowers shall promptly notify the Administrative Agent of any such event or occurrence and, to the extent so required, make any prepayment pursuant to Section 2.11(b)."

SECTION 3.03. Amendment to Section 3.01(c). Paragraph (c) of Section 3.01 of the Credit Agreement is amended and restated to read in its entirety as follows:

"(c) to the extent that an opinion of local counsel in the applicable state has not been previously provided with respect to another Property in the same state, receipt by the Administrative Agent of an opinion of local counsel satisfactory to the Agent and substantially in the form of the opinion of local counsel set forth in Exhibit P hereto and covering such additional matters relating to the transactions contemplated hereby as the Administrative Agent or any Bank may reasonably request;"

SECTION 3.04. Amendment to Section 3.01(g). Paragraph (g) of Section 3.01 of the Credit Agreement is amended and restated to read in its entirety as follows:

(g) the Membership Pledge Agreement, or in the case of Collateral added after the date hereof, the Addition of New Collateral Agreement, and the other Collateral Documents and Mortgage Property Support Documents applicable to the Borrowing Base Assets included in the Borrowing Base, each in form and content satisfactory to the Administrative Agent, shall have been duly executed by the Borrowers and Guarantors and shall have been delivered to the Administrative Agent and shall be in full force and effect (except to the extent delay in delivery of Mortgages is permitted pursuant to Section 2.14(d)) and each document (including each Uniform Commercial Code financing statement) required by law or reasonably requested by the Administrative Agent to be filed, registered or recorded in order to create in favor of the Administrative Agent for the benefit of the Secured Parties, upon filing, recording or possession by the Administrative Agent, as the case may be, a valid, legal and perfected first-priority security interest in and lien on the Collateral described in the Mortgages, Membership Pledge Agreement, and Mortgage Receivables Pledge Agreement, or, in the case of Collateral added after the date hereof, the Addition of New Collateral Agreement shall have been delivered to the Administrative Agent;

SECTION 3.05. Amendment to Section 5.25. Paragraphs (a) and (b) of Section 5.25 of the Credit Agreement are amended and restated to read in their entirety as follows:

(a) The Loan Parties shall cause any Person which becomes a Mortgaged Property Owner or a Pledged Mortgage Receivable Owner after the Closing Date to become a party to, and agree to be bound by the terms of (i) this Agreement as a Guarantor pursuant to an Addition of New Collateral Agreement, in substantially the

form attached hereto as Exhibit S and (ii) the Collateral Documents, in each case satisfactory to the Administrative Agent in all respects and executed and delivered to the Administrative Agent before such Mortgaged Property or Pledged Mortgage Receivable is included in the calculation of the Borrowing Base, except as otherwise provided in Section 2.14(d). The Borrowers shall also, except as otherwise provided in Section 2.14(d), cause the items specified in Section 3.01(c), (e), (g), (h) and (l) to be delivered to the Administrative Agent concurrently with the instruments referred to above, modified appropriately to refer to such instruments and such Mortgaged Property Owner or Pledged Mortgage Receivable Owner.

(b) The Borrowers shall, and shall cause any Person owning membership or limited partnership interests in a Mortgaged Property Owner or Pledged Mortgage Receivable Owner and each Person owning stock in a corporate general partner of a Mortgaged Property Owner or Pledged Mortgage Receivable Owner that is a limited partnership (each, a "Pledgor Owner") to: (i) to the extent not already a Borrower or Guarantor hereunder, join this Agreement as a Guarantor by executing an Addition of New Collateral Agreement in the form attached hereto as Exhibit S; (ii) pledge 100% of the membership or limited partnership interests of any Person which becomes a Mortgaged Property Owner or Pledged Mortgage Receivable Owner after the Closing Date and, in the case of a Mortgaged Property Owner or Pledged Mortgage Receivable Owner that is a limited partnership, also pledge 100% of the stock of the corporate general partner thereof, in each case pursuant to an Addition of New Collateral Agreement in substantially the form attached hereto as Exhibit S executed and delivered by the Borrower or such Pledgor Owner to the Administrative Agent within ten (10) Domestic Business Days after the day on which such Person became a Mortgaged Property Owner or Pledged Mortgage Receivable Owner; and (iii) deliver to the Administrative Agent such Certificates evidencing such membership interests, limited partnership interests or stock together with transfer powers executed in blank. The Borrowers shall also cause the items specified in Section 3.01(c), (e), (g), (h) and (l) to be delivered to the Administrative Agent concurrently with the Addition of New Collateral Agreement referred to above, modified appropriately to refer to such Addition of New Collateral Agreement, Pledgor Owner and such Mortgaged Property Owner or Pledged Mortgage Receivable Owner.

SECTION 4. Amendment of Exhibit N — Borrowing Base Certification Report. Exhibit N to the Credit Agreement is hereby amended and restated to read in its entirety as set forth on Exhibit N hereto.

SECTION 5. Addition of New Exhibit S — Addition of New Collateral Agreement. The Exhibits to the Credit Agreement are hereby amended to add a new Exhibit S as set forth on Exhibit S hereto.

SECTION 6. Conditions to Effectiveness. The effectiveness of this Amendment and the obligations of the Administrative Agent and the Banks hereunder are subject to the following conditions, unless the Required Banks waive such conditions:

(a) receipt by the Administrative Agent from each of the parties hereto of a duly executed counterpart of this Amendment signed by such party;

(b) the fact that the representations and warranties of the Borrower contained in Section 6 of this Amendment shall be true on and as of the date hereof; and

(c) receipt by each Bank of new Notes reflecting the new Commitment levels;

(d) receipt of an opinion of Borrowers' counsel, in form and substance satisfactory to the Administrative Agent, with respect to the due authorization, execution, delivery and enforceability of this Amendment, the new Notes and the Addition of New Collateral Agreement and with respect to such other matters as the Administrative Agent may reasonably request.

SECTION 7. No Other Amendment or Waiver. Except for the amendments set forth above, the text of the Credit Agreement shall remain unchanged and in full force and effect. This Amendment is not intended to effect, nor shall it be construed as, a novation. The Credit Agreement and this Amendment shall be construed together as a single agreement. Nothing herein contained shall waive, annul, vary or affect any provision, condition, covenant or agreement contained in the Credit Agreement, except as herein amended, nor affect nor impair any rights, powers or remedies under the Credit Agreement as hereby amended. The Banks and the Administrative Agent do hereby reserve all of their rights and remedies against all parties who may be or may hereafter become secondarily liable for the repayment of the Obligations. The Borrower promises and agrees to perform all of the requirements, conditions, agreements and obligations under the terms of the Credit Agreement, as heretofore and hereby amended, the Credit Agreement, as amended, and the other Loan Documents being hereby ratified and affirmed. The Borrower hereby expressly agrees that the Credit Agreement, as amended, and the other Loan Documents are in full force and effect.

SECTION 8. Representations and Warranties. The Borrowers and the Guarantors hereby represent and warrant to the Administrative Agent and each of the Banks as follows:

(a) No Default or Event of Default, nor any act, event, condition or circumstance which with the passage of time or the giving of notice, or both, would constitute an Event of Default, under the Credit Agreement or any other Loan Document has occurred and is continuing.

(b) The Borrowers and the Guarantors each have the power and authority to enter into this Amendment, the New Notes and the Addition of New Collateral Agreement and to do all acts and things as are required or contemplated hereunder or thereunder to be done, observed and performed by them.

(c) Each of this Amendment, the new Notes and the Addition of New Collateral Agreement has been duly authorized, validly executed and delivered by one or more authorized officers or managers of the Borrowers and the Guarantors and constitutes the legal, valid and binding obligation of the Borrowers and the Guarantors enforceable against each of them in accordance with its terms, provided that such enforceability is subject to general principles of equity.

(d) The execution and delivery of this Amendment, the new Notes and the Addition of New Collateral Agreement and the performance by the Borrowers and the Guarantors hereunder and thereunder do not and will not require the consent or approval of any regulatory authority or governmental authority or agency having jurisdiction over the Borrowers or the Guarantors nor be in contravention of or in conflict with the articles of incorporation, bylaws, operating agreement or other organizational documents of the Borrower or the Guarantors or the provision of any statute, or any judgment, order or indenture, instrument, agreement or undertaking, to which the Borrowers or the Guarantors is party or by which the assets or properties of the Borrower or the Guarantors are or may become bound.

SECTION 9. Counterparts. This Amendment may be executed in multiple counterparts, each of which shall be deemed to be an original and all of which, taken together, shall constitute one and the same agreement.

SECTION 10. Governing Law. This Amendment shall be construed in accordance with and governed by the laws of the State of North Carolina.

SECTION 11. Effective Date. This Amendment shall be effective as of the date hereof.

IN WITNESS WHEREOF, the parties hereto have executed and delivered, or have caused their respective duly authorized officers or representatives to execute and deliver, this Amendment as of the day and year first above written.

GLADSTONE COMMERCIAL CORPORATION

By: ____(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

GLADSTONE COMMERCIAL LIMITED PARTNERSHIP

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ____(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

EE, 208 SOUTH ROGERS LANE, RALEIGH, NC LLC

By: Gladstone Commercial Limited Partnership
its Manager

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ____(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

LITTLE ARCH CHARLOTTE NC LLC

By: Gladstone Commercial Limited Partnership
its Manager

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ____(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

OB CRENSHAW PA GLADSTONE COMMERCIAL LLC

By: Gladstone Commercial Limited Partnership
its Manager

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ____(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

OB MIDWAY NC GLADSTONE COMMERCIAL LLC

By: Gladstone Commercial Limited Partnership
its Manager

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ____(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

GCC POCONO LLC

By: Gladstone Commercial Limited Partnership
its Manager

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ____(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

GCC NORFOLK LLC

By: **Gladstone Commercial Limited Partnership**
its Manager

By: **Gladstone Commercial Partners, LLC**
its General Partner

By: **Gladstone Commercial Corporation**
its Manager

By: ______________________________________(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

FIRST PARK TEN COCO SAN ANTONIO, L.P.

By: **GCC COCO, Inc.**
its General Partner

By: ______________________________________(SEAL)
Arthur S. Cooper, President

TUSCANY AUSTIN GCC L.P.

By: **GCC COCO, Inc.**
its General Partner

By: ______________________________________(SEAL)
Arthur S. Cooper, President

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COMMITMENTS:	BRANCH BANKING AND TRUST COMPANY, as Administrative Agent and as a Bank
$30,000,000	By: ______________________________(SEAL) James C. Stallings III Vice President

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COMMITMENTS:	FIRST HORIZON BANK, a Division of First Tennessee Bank, NA
$15,000,000	By: ________________________________(SEAL) Susan L. Springfield Senior Vice President

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COMMITMENTS:	COMPASS BANK
$15,000,000	By: ______________________________(SEAL) T. Ray Sandefur Senior Vice President

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EXHIBIT N

[FORM OF BORROWING BASE CERTIFICATION]

GLADSTONE COMMERCIAL CORPORATION
GLADSTONE COMMERCIAL LIMITED PARTNERSHIP

Borrowing Base Certification Report

___________ ___, 20__

BORROWING BASE ASSETS

A. Mortgaged Properties with Delivered Mortgages:

1.
(a) Name of Mortgaged Property: ______________________

(b) Does it Meet All Requirements of Definitions of Eligible Property and Mortgaged Property including a delivered Mortgage? (If no, then enter $0 in line (f)) ______________________

(c) Acquisition Cost of Mortgaged Property: ______________________

(d) Applicable Appraised Value of Mortgaged Property (Based on Applicable Appraisal under definition of Borrowing Base Value): ______________________

(e) Potential Borrowing Base Value (Lesser of (c) and (d) above): ______________________

(f) Actual Borrowing Base Value (Lesser of (e) and $19,230,000): ______________________

2.
(a) Name of Mortgaged Property: ______________________

(b) Does it Meet All Requirements of Definitions of Eligible Property and Mortgaged Property including a delivered Mortgage? (If no, then enter $0 in line (f)) ______________________

(c) Acquisition Cost of Mortgaged Property: ______________________

(d) Applicable Appraised Value of Mortgaged Property (Based on Applicable Appraisal under definition of Borrowing Base Value): ______________________

(e) Potential Borrowing Base Value (Lesser of (c) and (d) above): ______________________

(f) Actual Borrowing Base Value (Lesser of (e) and $19,230,000): ______________________

3.
(a) Name of Mortgaged Property: ______________________

(b) Does it Meet All Requirements of Definitions of Eligible Property and Mortgaged Property including a Delivered Mortgage? (If no, then enter $0 in line (f)) ______________________

(c) Acquisition Cost of Mortgaged Property: ______________________

(d) Applicable Appraised Value of Mortgaged Property (Based on Applicable Appraisal under definition of Borrowing Base Value): ______________________

(e) Potential Borrowing Base Value (Lesser of (c) and (d) above): ______________________

(f) Actual Borrowing Base Value (Lesser of (e) and $19,230,000): ______________________

B. Mortgaged Properties with Pending Mortgages:

1.

(a) Name of Mortgaged Property: ______________________

(b) Does it Meet All Requirements of Definitions of Eligible Property and Mortgaged Property except that a Mortgage has not yet been delivered and less than 45 days have elapsed since the inclusion of the Mortgaged Property in the Borrowing Base? (If no, then enter $0 in line (f)) ______________________

(c) Acquisition Cost of Mortgaged Property: ______________________

(d) Applicable Appraised Value of Mortgaged Property (Based on Applicable Appraisal under definition of Borrowing Base Value): ______________________

(e) Potential Borrowing Base Value (Lesser of (c) and (d) above): ______________________

(f) Actual Borrowing Base Value (Lesser of (e) and $19,230,000): ______________________

2.

(a) Name of Mortgaged Property: ______________________

(b) Does it Meet All Requirements of Definitions of Eligible Property and Mortgaged Property except that a Mortgage has not yet been delivered and less than 45 days have elapsed since the inclusion of the Mortgaged Property in the Borrowing Base? (If no, then enter $0 in line (f)) ______________________

(c) Acquisition Cost of Mortgaged Property: ______________________

(d) Applicable Appraised Value of Mortgaged Property (Based on Applicable Appraisal under definition of Borrowing Base Value): ______________________

(e) Potential Borrowing Base Value (Lesser of (c) and (d) above): ______________________

(f) Actual Borrowing Base Value (Lesser of (e) and $19,230,000): ______________________

C. Pledged Mortgage Receivables:

1.

(a) Name of Pledged Mortgage Receivable: ______________________

(b) Does it Meet All Requirements of Definitions of Eligible Mortgage Receivable and Pledged Mortgage Receivable? (If no, then enter $0 in line (g)) ______________________

(c) Face Amount of Pledged Mortgage Receivable: ______________________

(d) Outstanding Principal Balance of Pledged Mortgage Receivable: ______________________

(e) Lesser of (c) and (d): ______________________

(f) Applicable Appraised Value of Mortgage Receivable Property: (Based on Applicable Appraisal under definition of Borrowing Base Value): ______________________

(g) Borrowing Base Value (lesser of (e) and (f)): ______________________

2.

(a) Name of Pledged Mortgage Receivable: ______________________

(b) Does it Meet All Requirements of Definitions of Eligible Mortgage Receivable and Pledged Mortgage Receivable? (If no, then enter $0 in line (g)) ______________________

(c) Face Amount of Pledged Mortgage Receivable: ______________________

(d) Outstanding Principal Balance of Pledged Mortgage Receivable: ______________________

(e) Lesser of (c) and (d): ______________________

(f) Applicable Appraised Value of Mortgage Receivable Property: (Based on Applicable Appraisal under definition of Borrowing Base Value): ______________________

(g) Borrowing Base Value (lesser of (e) and (f)): ______________________

3.

(a) Name of Pledged Mortgage Receivable: ______________________

(b) Does it Meet All Requirements of Definition of Eligible Mortgage Receivable and Pledged Mortgage Receivable? (If no, then enter $0 ______________________

in line (g))

(c) Face Amount of Pledged Mortgage Receivable: __________

(d) Outstanding Principal Balance of Pledged Mortgage Receivable: __________

(e) Lesser of (c) and (d): __________

(f) Applicable Appraised Value of Mortgage Receivable Property: (Based on Applicable Appraisal under definition of Borrowing Base Value): __________

(g) Borrowing Base Value (lesser of (e) and (f)): __________

D. Sum of All Line (f)s in Section A: __________

E. Sum of All Line (f)s in Section B: __________

F. Sum of All Line (g)s in Section C: __________

G. AGGREGATE BORROWING BASE VALUES BEFORE CAPS (Sum of Lines D, E and F): __________

H. 20% of G __________

I. 15% of G __________

J. Lesser of Lines E or H (PENDING MORTGAGE SUBLIMIT): __________

K. Lesser of Lines F or I (MORTGAGE RECEIVABLE SUBLIMIT): __________

L. TOTAL INCLUDABLE BORROWING BASE VALUES (AFTER 2 SUBLIMITS) (Sum of Lines D, J and K): __________

M. BORROWING BASE AMOUNT (65% of Line L) __________

EXHIBIT S

[FORM OF ADDITION OF NEW COLLATERAL AGREEMENT]

Execution Version

ADDITION OF NEW COLLATERAL AGREEMENT

THIS ADDITION OF NEW COLLATERAL AGREEMENT (the “Agreement”), dated as of this 6th day of July, 2005, is among Gladstone Commercial Corporation, a Maryland corporation (the “Company”), Gladstone Commercial Limited Partnership, a Delaware limited partnership (the “Operating Partnership” and together with the Company, the “Borrowers”), Gladstone Lending LLC, a Delaware limited liability company as an existing guarantor and pledgor of a new Mortgage Receivable, Corning Big Flats, LLC, a Delaware limited liability company (“Corning”), SLEE Grand Prairie, L.P., a Delaware limited partnership (“SLEE”), 2525 N Woodlawn Vstrm Wichita, KS, LLC, a Delaware limited liability company (“Voicestream”) and together with Corning and SLEE, the “New Guarantors”), and Branch Banking and Trust Company, a national banking association, acting as Administrative Agent (in such capacity, the “Administrative Agent”) for itself and other Secured Parties (as defined in the Credit Agreement referred to below). Capitalized terms used in this Agreement which are not otherwise defined in this Agreement shall have the respective meanings assigned to them in the Credit Agreement (as hereinafter defined).

RECITALS:

1. Reference is made to: (i) that certain Credit Agreement dated as of February 28, 2005, as amended (referred to herein as the “Credit Agreement”) among the Borrowers, the Guarantors, the Administrative Agent and the Banks, (ii) a certain Equity Pledge Agreement dated as of April 21, 2005 (referred to herein as the “Equity Pledge Agreement”) by the Company and the Operating Partnership in favor of the Agent, (iii) a certain Mortgage Receivables Pledge Agreement dated as of April 21, 2005 (the “Receivables Pledge Agreement”) by Gladstone Lending LLC in favor of the Agent.

2. The Borrowers have requested pursuant to Section 2.14(b) of the Credit Agreement that three additional Mortgaged Properties located in Chemung County, New York, Tarrant County, Texas and Sedgwick County, Kansas (the “New Mortgaged Properties”) and one additional Mortgage Receivable for property located in Fairfax County, Virginia and more fully described on Schedule C hereto (the “New Mortgage Receivable, and, together with the New Mortgaged Properties, the “New Collateral”) be included in calculations of the Borrowing Base and as Collateral under the Credit Agreement and the Loan Documents and the Administrative Agent and the Required Banks have accepted the New Collateral as Borrowing Base Assets, subject to the execution and delivery hereof and the various other deliveries and requirements under the Credit Agreement and Loan Documents.

3. Pursuant to and as required by Section 5.25 of the Credit Agreement, the New Guarantors desire to join the Credit Agreement as Guarantors thereunder.

4. Pursuant to and as required by Section 5.25 of the Credit Agreement, the Operating Partnership desires to pledge all of its equity interests in the three New Guarantors as Collateral for the Loans by amending the Equity Pledge Agreement to add the equity interests in the three New Guarantors to Exhibit A thereto.

5. Pursuant to and as required by Section 5.25 of the Credit Agreement, Gladstone Lending LLC desires to pledge the New Mortgage Receivable as Collateral for the Obligations by amending the Receivable Pledge Agreement to add the New Mortgage Receivable to the list of Pledged Mortgage Receivables set forth in Exhibit A thereto.

Accordingly, in consideration of the Recitals and the premises and mutual covenants herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. Joinder and Reaffirmation of Credit Agreement. Each New Guarantor and each Borrower hereby acknowledges and agrees that, by its execution of this Agreement, each New Guarantor will be deemed to be a party to the Credit Agreement and a "Guarantor" for all purposes of the Credit Agreement, the Notes and the other Loan Documents, and shall have all of the obligations of a Guarantor thereunder as if it had executed the Credit Agreement and the other Loan Documents. Each New Guarantor assumes and agrees to be bound by and comply with, all of the terms, provisions and conditions contained in the Credit Agreement and the other Loan Documents, and all duties and obligations thereunder, as fully and completely as all other Guarantors thereunder, jointly and severally, individually and collectively, with all other Guarantors, including without limitation (i) all of the representations, warranties, covenants, undertakings and obligations set forth in the Credit Agreement and the other Loan Documents, and (ii) all waivers set forth in the Credit Agreement and the other Loan Documents. Each New Guarantor has received a copy of the Credit Agreement and the Schedules and Exhibits thereto and the other Loan Documents. The information on the Exhibits and Schedules to the Credit Agreement are amended to provide the information shown on the attached Schedule A. Each New Guarantor hereby waives presentment, demand, protest, acceptance, notice of demand, protest and nonpayment and any other notice required by law relative to the Credit Agreement, the Obligations, the Notes and the other Loan Documents. To induce the Administrative Agent and Banks to enter into this Addition of New Collateral Agreement, the Borrowers, New Guarantors and Existing Guarantors hereby (a) restate and renew each and every representation and warranty heretofore made by them under, or in connection with the execution and delivery of, the Credit Agreement and the other Loan Documents; (b) restate, ratify and reaffirm each and every term and condition set forth in the Credit Agreement and in the Loan Documents, effective as of the date hereof; (c) acknowledge and agree that, as of the date hereof, there exists no right of offset, defense, counterclaim or objection in favor of any Borrower or any Loan Party as against the Administrative Agent or any Bank with respect to the payment or performance of its Obligations; and (d) certify that no Default or Event of Default exists. Borrowers and New Guarantors agree to pay upon request the actual costs and expenses of the Administrative Agent and Banks reasonably incurred in connection with the preparation, execution, delivery and enforcement of this Addition of New Collateral Agreement and all other Loan Documents executed in connection herewith, the closing hereof, and any other transactions contemplated hereby, including the reasonable fees and out-of-pocket expenses of Administrative Agent's legal counsel.

2. Amendment to Equity Pledge Agreement. Exhibit A of the Equity Pledge Agreement is hereby amended to read in its entirety as set forth in Schedule B hereto. By its execution hereof, the Operating Partnership hereby pledges, hypothecates, delivers and assigns and grants unto Administrative Agent, as Administrative Agent for itself and the Secured Parties,

a security interest (which security interest shall constitute a first priority security interest), in all of the Pledgor's membership interests of Corning and Voicestream, all of the limited partnership interests of SLEE and all of the membership interests of GCC Acquisition Holdings LLC, the general partner of SLEE, as described on said Schedule B and confirms all the terms and conditions, representations, warranties, covenants and other provisions of the Equity Pledge Agreement as fully as if set forth herein.

3. Amendment to Receivables Pledge Agreement. Exhibit A of the Receivables Pledge Agreement is hereby amended to read in its entirety as set forth in Schedule C hereto. By its execution hereof, Gladstone Lending LLC hereby pledges, hypothecates, delivers and assigns and grants to the Administrative Agent, as agent for the Secured Parties, a lien and continuing security interest in all of the Pledgors' right, title and interest in, to and under (but none of the obligations under) the New Mortgage Receivable described on said Schedule C and confirms all the terms and conditions, representations, warranties, covenants and other provisions of the Receivables Pledge Agreement as fully as if set forth herein.

4. Power of Attorney. Each of the New Guarantors hereby irrevocably constitutes and appoints Branch Banking and Trust Company, as Administrative Agent under the Credit Agreement (hereinafter referred to as "Attorney") (and all officers, employees or agents designated by Attorney), with full power of substitution, as its true and lawful attorney-in-fact with full irrevocable power and authority in its place and stead and in its name or in Attorney's own name, from time to time in Attorney's discretion, to take any and all appropriate action and to execute and deliver any and all documents and instruments that may be necessary or desirable to accomplish the purposes of the Agreement and other Loan Documents, and, without limiting the generality of the foregoing, hereby grants to Attorney the power and right, on its behalf, without notice to or assent by it, upon the occurrence and during the continuance of any Event of Default, to do the following: (a) open mail for the New Guarantors, and ask, demand, collect, give acquittances and receipts for, take possession of, or endorse and receive payment of, any checks, drafts, notes, acceptances, or other instruments for the payment of moneys due, and sign and endorse any invoices, freight or express bills, bills of lading, storage or warehouse receipts, drafts against debtors, assignments, verifications, and notices in connection with any of the New Guarantors' property; (b) effect any repairs to any of the New Guarantors' assets, or continue or obtain any insurance and pay all or any part of the premiums therefor and costs thereof, and make, settle and adjust all claims under such policies of insurance, and make all determinations and decisions with respect to such policies; (c) pay or discharge any taxes, Liens, or other encumbrances levied or placed on or threatened against the New Guarantors or the New Guarantors' property; (d) defend any suit, action or proceeding brought against the New Guarantors if the New Guarantors do not defend such suit, action or proceeding or if Attorney believes that it is not pursuing such defense in a manner that will maximize the recovery to Attorney, and settle, compromise or adjust any suit, action, or proceeding described above and, in connection therewith, give such discharges or releases as Attorney may deem appropriate; (e) file or prosecute any claim, litigation, suit or proceeding in any court of competent jurisdiction or before any arbitrator, or take any other action otherwise deemed appropriate by Attorney for the purpose of collecting any and all such moneys due to the New Guarantors whenever payable and to enforce any other right in respect of the New Guarantors' property; (f) sell, transfer, pledge, make any agreement with respect to, or otherwise deal with, any of the New Guarantors' property, and execute, in connection with such sale or action, any

endorsements, assignments or other instruments of conveyance or transfer in connection therewith; and (g) cause the certified public accountants then engaged by the New Guarantors to prepare and deliver to Attorney at any time and from time to time, promptly upon Attorney's request, any reports required to be prepared by or on behalf of the New Guarantors under the Agreement or any other Loan Document, all as though Attorney were the absolute owner of its property for all purposes, and to do, at Attorney's option and the New Guarantors' expense, at any time or from time to time, all acts and other things that Attorney reasonably deems necessary to perfect, preserve, or realize upon its property or assets and the Liens of the Administrative Agent as agent for the Secured Parties thereon, all as fully and effectively as it might do. Each of the New Guarantors hereby ratifies, to the extent permitted by law, all that said Attorney shall lawfully do or cause to be done by virtue hereof. No person to whom this Power of Attorney is presented, as authority for Attorney to take any action or actions contemplated hereby, shall inquire into or seek confirmation from any of the New Guarantors as to the authority of Attorney to take any action described below, or as to the existence of or fulfillment of any condition to this Power of Attorney, which is intended to grant to Attorney unconditionally the authority to take and perform the actions contemplated herein, and each of the New Guarantors irrevocably waives any right to commence any suit or action, in law or equity, against any person or entity that acts in reliance upon or acknowledges the authority granted under this Power of Attorney. The power of attorney granted hereby is coupled with an interest and may not be revoked or canceled by the New Guarantors until their respective Obligations under the Loan Documents have been indefeasibly paid in full and Attorney has provided its written consent thereto.

5. No Other Amendments. Except as set forth expressly herein, all terms of the Credit Agreement, the Equity Pledge Agreement, the Receivables Pledge Agreement and the other Loan Documents, shall be and remain in full force and effect, and such documents are hereby ratified and affirmed. This Agreement and each of the documents amended herein shall be construed together as a single agreement. Nothing herein contained shall waive, annul, vary or affect any provision, condition, covenant or agreement contained in the Credit Agreement, the Equity Pledge Agreement, the Receivables Pledge Agreement and the other Loan Documents except as herein amended, nor affect nor impair any rights, powers, or remedies available under the Credit Agreement, the Equity Pledge Agreement, the Receivables Pledge Agreement and the other Loan Documents except as herein amended, nor affect nor impair any rights, powers or remedies under the Credit Agreement, the Equity Pledge Agreement, the Receivables Pledge Agreement and the other Loan Documents as hereby amended. The Banks and the Administrative Agent do hereby reserve all their rights and remedies against all parties who may be or may hereafter become secondarily liable for the repayment of the Obligations.

6. Counterparts. This Agreement may be executed in multiple counterparts, each of which shall be deemed an original and all of which, taken together, shall constitute one and the same agreement.

7. Governing Law. This Agreement shall be construed in accordance with and governed by the laws of the State of North Carolina.

NEW GUARANTORS:

CORNING BIG FLATS, LLC

By: Gladstone Commercial Limited Partnership
its Manager

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ____(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

SLEE GRAND PRAIRIE, L.P.

By: GCC Acquisition Holdings, LLC
its General Partner

By: Gladstone Commercial Limited Partnership
its Manager

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ____(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

2525 N WOODLAWN VSTRM, WICHITA, KS, LLC

By: Gladstone Commercial Limited Partnership
its Manager

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ______________________________(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

BORROWERS:

GLADSTONE COMMERCIAL CORPORATION

By: ______________________________(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

GLADSTONE COMMERCIAL LIMITED PARTNERSHIP

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ______________________________(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

NEW MORTGAGE RECEIVABLE PLEDGOR:

GLADSTONE LENDING LLC

By: Gladstone Commercial Limited Partnership
its Manager

By: Gladstone Commercial Partners, LLC
its General Partner

By: Gladstone Commercial Corporation
its Manager

By: ________________________________(SEAL)
George Stelljes III
Executive Vice President
and Chief Investment Officer

BANKS:

BRANCH BANKING AND TRUST COMPANY, as Administrative Agent and as a Bank

By: ____(SEAL)
Title: ____

FIRST HORIZON BANK, a Division of First Tennessee Bank, NA

By: ____(SEAL)
Susan L. Springfield
Senior Vice President

COMPASS BANK

By: ____(SEAL)
T. Ray Sandefur
Senior Vice President

Schedule A

[Provide information here to update Schedules and Exhibits to the Credit Agreement and other Loan Documents]

Schedule B

Exhibit A

NAMES, ADDRESSES, PLEDGED EQUITY INTERESTS AND STATES OF ORGANIZATION OF PLEDGED SUBSIDIARIES

Pledged Subsidiary	Address	Equity Interest	State of Organization
Tuscany Austin GCC L.P.	1521 Westbranch Road, Suite 200 McLean, VA 22102 Attn: George Stelljes III	100% of Limited Partnership Interests (Uncertificated)	Delaware
GCC Norfolk LLC	1521 Westbranch Road, Suite 200 McLean, VA 22102 Attn: George Stelljes III	100% of Membership Interests (Uncertificated)	Delaware
First Park Ten Coco San Antonio, L.P.	1521 Westbranch Road, Suite 200 McLean, VA 22102 Attn: George Stelljes III	100% of Limited Partnership Interests (Uncertificated)	Delaware
Gladstone Lending LLC	1521 Westbranch Road, Suite 200 McLean, VA 22102 Attn: George Stelljes III	100% of Membership Interests (Uncertificated)	Delaware
GCC COCO, Inc.	1521 Westbranch Road, Suite 200 McLean, VA 22102 Attn: George Stelljes III	100% of Common Stock, no par value	Delaware
Corning Big Flats, LLC	1521 Westbranch Road, Suite 200 McLean, VA 22102 Attn: George Stelljes III	100% of Membership Interests (Uncertificated)	Delaware
SLEE Grand Prairie, L.P.	1521 Westbranch Road, Suite 200 McLean, VA 22102 Attn: George Stelljes III	100% of Limited Partnership Interests (Uncertificated)	Delaware
GCC Acquisition Holdings LLC	1521 Westbranch Road, Suite 200 McLean, VA 22102 Attn: George Stelljes III	100% of Membership Interests (Uncertificated)	Delaware
2525 N Woodlawn Vstrm Wichita, KS, LLC	1521 Westbranch Road, Suite 200 McLean, VA 22102 Attn: George Stelljes III	100% of Membership Interests (Uncertificated)	Delaware

Schedule C

Exhibit A

PLEDGORS' NAMES, ADDRESSES and STATES OF ORGANIZATION AND DESCRIPTION OF PLEDGED MORTGAGE RECEIVABLES

Name/Address	State of Organization	Description of Pledged Mortgage Receivables
Gladstone Lending LLC 1521 Westbranch Drive, Suite 200 McLean, VA 22102 Attn: George Stelljes III	Delaware	Mortgage: $11,170,000.00 Interest Rate: 10.00% Maturity Date: 02/18/2014 Mortgagor: Mayco Property Holdings LLC (Stonebridge Industries) 42400 Merrill Road Sterling Heights (Macomb County), MI
Gladstone Lending LLC 1521 Westbranch Drive, Suite 200 McLean, VA 22102 Attn: George Stelljes III	Delaware	Mortgage: $10,000,000.00 Interest Rate: Greater of 7.5% or 600 basis points over the LIBOR Rate Maturity Date: 05/30/2017 Mortgagor: West*Stone, LLC 1600 Anderson Road McLean, (Fairfax County), VA

Exhibit 31.1

CERTIFICATION
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, David Gladstone, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Gladstone Commercial Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a—15(e) and 15d—15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a — 15(f) and 15d — 15(f)) for the registrant and we have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2005

/s/ DAVID GLADSTONE

David Gladstone
Chief Executive Officer and
Chairman of the Board of Directors

Exhibit 31.2

CERTIFICATION
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Harry Brill, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Gladstone Commercial Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a—15(e) and 15d—15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a—15(f) and 15d—15(f)) for the registrant and we have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and

d) disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 2, 2005

/s/ HARRY BRILL

Harry Brill
Chief Financial Officer and Treasurer

Exhibit 32.1

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned, the Chief Executive Officer of Gladstone Commercial Corporation (the “Company”), hereby certifies on the date hereof, pursuant to 18 U.S.C. §1350(a), as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q for the quarter ended June 30, 2005 (“Form 10-Q”), filed concurrently herewith by the Company, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities Exchange Commission or its staff upon request.

Dated: August 2, 2005

/s/ David Gladstone

David Gladstone
Chief Executive Officer

Exhibit 32.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned, the Chief Financial Officer of Gladstone Commercial Corporation (the "Company"), hereby certifies on the date hereof, pursuant to 18 U.S.C. §1350(a), as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q for the quarter ended June 30, 2005 ("Form 10-Q"), filed concurrently herewith by the Company, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities Exchange Commission or its staff upon request.

Dated: August 2, 2005

/s/ Harry Brill

Harry Brill
Chief Financial Officer