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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM S-11**

**REGISTRATION STATEMENT**

**UNDER  
THE SECURITIES ACT OF 1933**

**Gladstone Commercial Corporation**

*(Exact Name of Registrant as Specified in its Governing Instruments)*

**1750 Tysons Blvd., Fourth Floor**

**McLean, Virginia 22102  
(703) 744-1165**

*(Address, Including Zip Code, and Telephone Number, including  
Area Code, of Registrant's Principal Executive Offices)*

**David Gladstone**

**Chairman and Chief Executive Officer  
Gladstone Commercial Corporation**

**1750 Tysons Blvd., Fourth Floor**

**McLean, Virginia 22102  
(703) 744-1165**

**(703) 286-0795 (facsimile)**

*(Name, Address, Including Zip Code, and Telephone Number,  
Including Area Code, of Agent for Service)*

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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after the effective date of this Registration Statement.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If deliver of the prospectus is expected to be made pursuant to Rule 434, check the following box.

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**CALCULATION OF REGISTRATION FEE**

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Title of securities being registered	Amount to be Registered(1)	Proposed maximum offering price per share(2)	Proposed maximum aggregate offering price(2)	Amount of registration fee
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Common Stock, \$0.001 par value per share	5,200,000 shares	\$ 15.00	\$ 78,000,000	\$ 6,310.20
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- (1) Includes 780,000 shares subject to sale pursuant to the underwriters' over-allotment option.
- (2) Estimated solely for the purpose of calculating the amount of the registration fee pursuant to Rule 457(o) under the Securities Act of 1933.

**The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until this registration statement shall become effective on such date as the Commission, acting pursuant to Section 8(a), may determine.**

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**The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**Subject to Completion Dated June 11, 2003**

## **GLADSTONE COMMERCIAL CORPORATION**

### **4,420,000 Shares of Common Stock**

We are a recently formed company that intends to invest in and own net leased industrial and commercial real property and make long-term industrial and commercial mortgage loans. We anticipate that a large portion of our tenants will be small and medium-sized businesses having significant buyout fund ownership. We will elect to be taxed as a real estate investment trust, or REIT, under federal tax laws. Gladstone Management Corporation serves as our adviser and will manage our real estate portfolio.

This is our initial public offering and no public market currently exists for our common stock. We expect the initial public offering price to be \$15.00 per share. We have filed an application for quotation of our common stock on the Nasdaq National Market under the symbol "GOOD."

**Investing in our common stock involves risks that are described in the "Risk Factors" section beginning on page 6 of this prospectus. Some risks include:**

- Lack of operating history or designated use of net proceeds of the offering
- Risks inherent in single tenant and special use net leased property
- Risks associated with real estate ownership and lending
- Uncertainty as to our dividend rate
- Conflicts of interest between us, our Adviser, its officers and directors and their affiliates
- No present designation of specific properties to be purchased or loans to be made
- Leverage maintained by some of our tenants and borrowers
- Risks associated with borrowed money
- Loss of tax status as a REIT
- Dependence on our Adviser and its officers for management of our business

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	<b>Per Share</b>	<b>Total</b>
Public Offering Price	\$	\$
Underwriting Discount	\$	\$
Proceeds, before expenses, to us	\$	\$

The underwriters may also purchase up to an additional 780,000 shares of common stock at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus solely to cover over-allotments.

The underwriters expect to deliver the shares of common stock on \_\_\_\_\_, 2003.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

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**Ferris, Baker Watts**

Incorporated

The date of this prospectus is \_\_\_\_\_, 2003.

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## PROSPECTUS SUMMARY

*This summary highlights some information from this prospectus. It may not include all of the information that is important to you. To understand this offering fully, you should read the entire prospectus carefully, including Risk Factors. Unless the context suggests otherwise, when we use the term “we” or “us” or “Gladstone Commercial,” we are referring to Gladstone Commercial Corporation and Gladstone Commercial Limited Partnership and not to our Adviser, Gladstone Management Corporation. When we use the term “Adviser” we are referring to our Adviser, Gladstone Management Corporation. Unless otherwise indicated, the information included in this prospectus assumes no exercise of the underwriters’ over-allotment option.*

### **General**

Gladstone Commercial Corporation was incorporated under the General Corporation Laws of the State of Maryland on February 14, 2003 primarily for the purpose of investing in and owning net leased industrial and commercial real property and making long-term industrial and commercial mortgage loans. We expect that most of our tenants and borrowers will be small and medium-sized businesses having significant buyout fund ownership and will be well capitalized. Although we have not yet purchased any properties or made any loans, we are actively seeking and evaluating properties for potential acquisition or mortgage financing.

We will conduct substantially all of our activities through, and substantially all of our properties will be held directly or indirectly by, Gladstone Commercial Limited Partnership, a Delaware limited partnership formed on May 28, 2003 that we refer to herein as our “Operating Partnership.” We will control our Operating Partnership as its sole general partner and will also initially 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. 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 after the first anniversary of the completion of this offering.

We intend to qualify as a real estate investment trust, or a “REIT”, for federal tax purposes. Our office is at 1750 Tysons Blvd., Fourth Floor, McLean, Virginia 22102. Our phone number is (703) 744-1165 and our internet website address will be [www.GladstoneCommercial.com](http://www.GladstoneCommercial.com). The information contained on our website is not a part of this prospectus.

### **Our Opportunity**

Businesses that have been acquired or recapitalized by buyout funds and many family-owned businesses often have substantial amounts of equity in their real estate. A primary reason for this is that real estate lenders have been making real estate loans at relatively low amounts when compared to the value of the real estate securing the loans. One method for these businesses to free up the equity in their real estate is by selling their real estate and simultaneously leasing it back under long term, triple net leases. Sellers in these “sale-leaseback” transactions can then use the freed up cash to repay existing indebtedness or for growth capital, thus strengthening their balance sheets and permitting them to lower their overall costs of capital for growth and expansion. We believe that there are many businesses in the United States that have a substantial amount of equity tied up in their real estate. Because of the experience of our Adviser’s professionals investing in real estate-related assets and managing funds that lend to similar businesses, we believe our Adviser is uniquely positioned to identify and evaluate these sale-leaseback opportunities and to negotiate attractive investments for us. We also believe there are a substantial number of businesses that would not be interested in a sale-leaseback transaction, but would benefit from refinancing their current real estate mortgage loans. To address this need, we will also offer long-term mortgage loans on competitive terms and conditions.

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

Our principal investment objectives are to generate income for distribution to our stockholders in the form of quarterly cash dividends that grow over time and to increase the value of our common stock. Our primary strategy to achieve our investment objectives is to invest in and own a diversified portfolio of leased industrial and commercial real estate that we believe will produce stable cash flow and increase in value. We expect to sell some of our real estate assets from time to time when our Adviser determines that doing so would be advantageous to us and our stockholders. We also expect to invest in mortgage loans secured by income-producing commercial or industrial real estate, which loans may have some form of equity participation. Additionally, we may purchase mortgage-backed securities, including mortgage pass-through certificates, collateralized mortgage obligations and other securities representing interests in or obligations backed by pools of mortgage loans. We intend to make quarterly distributions to our stockholders beginning within 120 days after we complete this offering.

Our strategy includes the use of leverage so that we may make more investments than would otherwise be possible in order to maximize potential returns to stockholders. We intend to use non-recourse financing that will allow us to limit our loss exposure on any property to the amount of equity invested in that property. We may also borrow funds on a short-term basis or incur other indebtedness. Some of our investments may be made through joint ventures that will permit us to own interests in large properties without restricting the diversity of our portfolio.

## **Our Adviser**

Gladstone Management Corporation, a Delaware corporation and a registered investment adviser, will serve as our adviser, and we refer to it in this prospectus as our “Adviser.” Under the terms of an advisory agreement between our Adviser and us, our Adviser will be 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.

Each of our officers, who are also officers of our Adviser, has significant experience in making investments in and lending to small and medium-sized businesses, including investing in real estate and making mortgage loans:

- David Gladstone, our chairman and chief executive officer and chairman and chief executive officer of our Adviser, has over 25 years experience in making loans to and investing in small and medium-sized companies at Gladstone Capital Corporation (NASDAQ: GLAD), Allied Capital Corporation (NYSE: ALD) and American Capital Strategies, Ltd. (NASDAQ: ACAS). While with Allied Capital, Mr. Gladstone served as chairman, president and chief executive officer of Allied Capital Commercial Corporation, a publicly traded REIT that made real estate loans to small and medium-sized businesses and as chairman, president and chief executive officer of Business Mortgage Investors, a private mortgage REIT. Both of these REITs were managed by Allied Capital Advisers, an entity for whom Mr. Gladstone served as chairman and chief executive officer. In addition, Allied Capital Advisers managed three public investment companies. Mr. Gladstone is also a former director of Capital Automotive REIT (NASDAQ: CARS), a real estate investment trust that leases real estate to automobile dealerships and automotive service, repair and related businesses.
- Terry Lee Brubaker, our president and chief operating officer and president and chief operating officer of our Adviser, has significant experience in investing in small and medium-sized businesses in his present role as president and chief operating officer of Gladstone Capital Corporation and has over 25 years experience in making acquisitions and managing companies following their acquisition. Mr. Brubaker was a co-architect and assisted in the implementation of the acquisition strategy of James River Corporation and managed several of its divisions.
- George Stelljes, III, our executive vice president and chief investment officer and the executive vice president and chief investment officer of our Adviser, has extensive experience in investing in and

lending to small and medium-sized companies at Gladstone Capital Corporation, Allied Capital Corporation and a number of venture capital firms.

In addition to Messrs. Gladstone, Brubaker and Stelljes, our Adviser currently has five professionals, which we call principals, who will be involved in structuring and arranging our transactions. Additionally, our Adviser plans to hire additional investing professionals following this offering. We believe that the expertise of our Adviser's professionals will help us to be successful in investing in real property and making long-term mortgage loans.

Our Adviser will have responsibility for all aspects of our operations including:

- selecting properties for potential acquisitions, evaluating and negotiating the terms of each proposed acquisition, and assisting in our consummation of the acquisitions;
- evaluating and negotiating the terms of commercial and industrial leases and mortgage loans that we choose to make or otherwise acquire;
- negotiating the terms of any borrowing we undertake, including lines of credit and any long-term financing;
- managing our day-to-day operations, including accounting, property management and investor relations; and
- arranging for and negotiating the disposition of our assets.

#### **Payments to our Adviser**

Under the terms of the advisory agreement we have with our Adviser, we will reimburse our Adviser for certain expenses it incurs related to its management of our activities. Since our advisory agreement permits our Adviser to provide services to other entities, its officers, directors and employees may also be working on business for others. However, we will only be required to reimburse the expenses of our Adviser for amounts related to our operations on the following bases:

- reimbursement on a dollar-for-dollar basis for all expenses incurred by our Adviser for our direct benefit (for example, organizational and offering expenses, legal, accounting, tax and consulting fees);
- reimbursement on a dollar-for-dollar basis for all additional fees charged by third parties that are directly related to our business (for example, real estate brokerage fees, mortgage placement fees, lease-up fees and transaction structuring fees); and
- reimbursement of our Adviser for our pro rata portion of our Adviser's total operating expenses, such as payroll and other overhead expenses, attributable to our business, based on the percentage of total hours worked by our Adviser's personnel that are spent on our matters. Such reimbursement for operating expenses shall not be greater than 2.5% of our average invested assets on an annual basis.

There are many conditions and restrictions on our reimbursement of our Adviser's expenses. For a more complete explanation of these amounts see "Our Adviser — Advisory Agreement — Payments to our Adviser Under the Advisory Agreement."

#### **Risk Factors**

You should carefully consider the matters discussed in the "Risk Factors" section of this prospectus beginning on page 6 prior to deciding to invest in our common stock. Some of the risks include:

- We are a new company with no operating history and may not be able to operate successfully.
- We have not identified any specific property to purchase or loan to make with the net proceeds we will receive from this offering.

- We are not currently able to set a dividend rate, and the dividend rate we fix in the future may have an adverse effect on the market price for our common stock.
- Highly leveraged tenants and borrowers may be unable to pay rent or make loan payments, which could adversely affect our cash available to pay dividends.
- Our real estate investments may include special use and single tenant properties that may be difficult to sell or re-lease upon tenant defaults or early lease terminations.
- The inability of a tenant in a single tenant property to pay rent will reduce our revenues.
- Our business strategy relies heavily on external financing, which may expose us to risks associated with leverage such as restrictions on additional borrowing and payment of dividends, risks associated with balloon payments and risk of loss of our equity upon foreclosure.
- We are subject to certain risks associated with real estate ownership and lending which could reduce the value of our investments.
- We may not qualify as a REIT for federal income tax purposes, which would subject us to federal income tax on our taxable income at regular corporate rates, thereby reducing the amount of funds available for paying distributions to stockholders.
- Our success will depend on the performance of our Adviser and you will not be able to evaluate the terms of our proposed investments.

#### **Our Affiliates**

All of our directors and executive officers are also affiliated with Gladstone Capital Corporation, a publicly held closed-end management investment company whose common stock is traded on the Nasdaq National Market under the trading symbol "GLAD." Gladstone Capital makes loans to and investments in small and medium-sized businesses. It does not buy or lease real estate. Gladstone Capital will not make loans to or investments in any company with which we have or intend to enter into a lease or loan. David Gladstone, our chairman and chief executive officer, also serves as chairman of Gladstone Land Corporation, a privately held corporation which invests primarily in agricultural real estate. We do not presently intend to co-invest with Gladstone Capital, Gladstone Land or any other affiliated entity in any business. However, in the future it may be advisable for us to co-invest with one of our affiliates. If we decide to change our policy on co-investments with affiliates, we will seek approval of this decision from our stockholders.

Our Adviser is a registered investment adviser and does not buy or lease real estate other than for its own use. Our Adviser will not make loans to or investments in any company with which we have or intend to enter into a lease or loan. We will not co-invest with our Adviser in any business or real estate transaction.

#### **Conflicts Of Interest**

Each of our officers is also an officer or director of our Adviser and Gladstone Capital. Our Adviser and its affiliates may have conflicts of interest in the course of performing their duties for us. These conflicts may include:

- Our Adviser may realize substantial commissions, fees and other compensation on account of its activities on our behalf;
- Our agreements with our Adviser are not arm's-length agreements;
- We may experience competition with our affiliates for financing transactions;
- Our Adviser or its affiliates could acquire property adjacent to properties held by us; and

- Our Adviser and other affiliates could compete for the time and services of our officers and directors.

The “Conflicts of Interest” section of this prospectus discusses in more detail the more significant of these potential conflicts of interest, as well as the procedures that have been established to mitigate a number of these potential conflicts.

### The Offering

Common stock offered by us (1) (2)	4,420,000 shares
Common stock to be outstanding after this offering (1)	4,472,000 shares
Use of proceeds	To purchase commercial and industrial real estate for lease and to fund commercial and industrial mortgage loans
Proposed Nasdaq Listing Symbol	GOOD
Distribution Policy	Consistent with our objective of qualifying as a REIT, we expect to pay quarterly distributions and distribute at least 90% of our REIT taxable income. We expect to commence quarterly distributions within 120 days after we complete this offering. Our board of directors will determine the amount of distributions we will pay.
Our Adviser	Pursuant to the terms of an advisory agreement, our Adviser will administer our day-to-day operations and select our real estate investments.

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- (1) Excludes 780,000 shares of our common stock issuable pursuant to the over-allotment option granted to the underwriters and shares of our common stock which may be purchased by our officers and directors upon the exercise of options.
  - (2) Up to \_\_\_\_\_ shares of our common stock to be sold in this offering will be reserved for sale by the underwriters to our directors, officers and employees and other persons designated by us at the public offering price, net of the underwriting discount. For more information, see “Underwriting—Directed Share Program.”



## RISK FACTORS

*Before you invest in our securities, you should be aware that your investment is subject to various risks, including those described below. You should carefully consider these risk factors together with all of the other information included in this prospectus before you decide to purchase our securities.*

### Risks Relating To Our Business

***We are a new company with no operating history and may not be able to operate successfully.***

We were incorporated in February 2003 and to date have not purchased any properties, made any mortgage loans or conducted any significant operations. In addition, we are subject to all of the business risks and uncertainties associated with any new business enterprise. Our failure to operate successfully or profitably or accomplish our investment objectives could have a material adverse effect on our ability to generate cash flow to make distributions to our stockholders and your investment in us may decline substantially or be reduced to zero.

***We have not identified any specific property to purchase or loan to make with the net proceeds we will receive from this offering.***

We have not yet identified any specific property to purchase or loan to make with the net proceeds we will receive from this offering. There can be no assurance that our Adviser will be able to identify or negotiate acceptable terms for the acquisition of, or mortgage loans with respect to, properties that meet our investment criteria, or that we will be able to acquire such properties or make such mortgage loans. Any significant delay in investing the proceeds of this offering would have a material adverse effect on our ability to generate cash flow and make distributions to our stockholders.

***We are not currently able to set a dividend rate, and the dividend rate we fix in the future may have an adverse effect on the market price for our common stock.***

Because we are newly organized and hold no properties or mortgage loans, we currently do not have the ability to predict the amount or timing of our cash flow or fix our dividend rate. Our dividend rate will depend entirely on the timing and amount of rent and mortgage payments from investments we make. Our failure to rapidly invest the net proceeds of this offering or make investments at acceptable rates of return could result in our fixing a dividend rate that is not competitive with alternative investments, which could adversely affect the market price for our common stock.

***Highly leveraged tenants or borrowers may be unable to pay rent or make loan payments, which could adversely affect our cash available to pay dividends.***

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

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

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

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

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

We intend to focus our investments on commercial and industrial properties which may include manufacturing facilities, special use storage or warehouse facilities and special use single tenant properties. These types of properties are relatively illiquid compared to other types of real estate and financial assets. This illiquidity will limit our ability to quickly change our portfolio in response to changes in economic or other conditions. With these properties, if the current lease is terminated or not renewed or, in the case of a mortgage loan, if we take such property in foreclosure, we may be required to renovate the property or to make rent concessions in order to lease the property to another tenant or sell the property. In addition, in the event we are forced to sell the property, we may have difficulty selling it to a party other than the tenant or borrower due to the special purpose for which the property may have been designed. These and other limitations may affect our ability to sell or re-lease properties without adversely affecting returns to our stockholders.

***The inability of a tenant in a single tenant property to pay rent will reduce our revenues.***

We expect that most of our properties will be occupied by a single tenant and, therefore, the success of our investments will be materially dependent on the financial stability of these tenants. Lease payment defaults by these tenants could adversely affect our cash flows and cause us to reduce the amount of distributions to stockholders. In the event of a default by a tenant, we may experience delays in enforcing our rights as landlord and may incur substantial costs in protecting our investment and re-leasing our property. If a lease is terminated, there is no assurance that we will be able to lease the property for the rent previously received or sell the property without incurring a loss.

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

Our acquisition strategy contemplates the use of leverage so that we may make more investments than would otherwise be possible in order to maximize potential returns to stockholders. If the income generated by our properties and other assets fails to cover our debt service, we could be forced to reduce or eliminate dividends to our stockholders and may experience losses. We may borrow on a secured or unsecured basis. Our board of directors has adopted a policy that our aggregate borrowing will not result in a total debt to total equity ratio greater than two-to-one. This coverage ratio means that, for each dollar of

equity we have, we can incur up to two dollars of debt. Our board of directors may change this policy at any time.

Our ability to achieve our investment objectives depends on our ability to borrow money in sufficient amounts and on favorable terms. We expect that we will borrow money that will be secured by our properties and that these financing arrangements will contain customary covenants such as those that limit our ability, without the prior consent of the lender, to further mortgage the applicable property or to discontinue insurance coverage. In addition, any credit facility we might enter into is likely to contain certain customary restrictions, requirements and other limitations on our ability to incur indebtedness, and will specify debt ratios that we will be required to maintain. Accordingly, we may be unable to obtain the degree of leverage we believe to be optimal, which may cause us to have less cash for distribution to stockholders than we would have with an optimal amount of leverage. Our use of leverage could also make us more vulnerable to a downturn in our business or the economy generally. There is also a risk that a significant increase in the ratio of our indebtedness to the measures of asset value used by financial analysts may have an adverse effect on the market price of our common stock.

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

We intend to make most of our property acquisitions by borrowing a portion of the purchase price and securing the loan with a mortgage on the property. If we are unable to make our debt payments as required, a lender could foreclose on the property or properties securing its loan. This could cause us to lose part or all of our investment in such property which in turn could cause the value of our common stock or the amount of distributions to our stockholders to be reduced.

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

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

- changes in the general economic climate;
- changes in local conditions such as an oversupply of space or reduction in demand for real estate;
- changes in interest rates and the availability of financing;
- competition from other available space; and
- changes in laws and governmental regulations, including those governing real estate usage, zoning and taxes.

***Competition for the acquisition of real estate may impede our ability to make acquisitions or increase the cost of these acquisitions, which could adversely affect our operating results and financial condition.***

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

to ours, which would decrease our competitive advantage in offering flexible transaction terms. In addition, the number of entities and the amount of funds competing for suitable investment properties may increase, resulting in increased demand and increased prices paid for these properties. If we pay higher prices for properties, our profitability may decrease, and you may experience a lower return on your investment. Increased competition for properties may also preclude us from acquiring those properties that would generate attractive returns to us.

*We expect to lease our properties or make mortgage loans to small and medium-sized businesses, which will expose us to additional risks unique to these entities.*

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

- *Small and medium-sized businesses may have limited financial resources and may not be able to make their lease or loan payments.* A small or medium-sized tenant or borrower is more likely to have difficulty making its lease or loan payments when it experiences adverse events, such as the failure to meet its business plan, a downturn in its industry or negative economic conditions.
- *Small and medium-sized businesses typically have narrower product lines and smaller market shares than large businesses.* Because our target tenants or borrowers are smaller businesses, they will tend to be more vulnerable to competitors' actions and market conditions, as well as general economic downturns. In addition, our target tenants or borrowers may face intense competition, including competition from companies with greater financial resources, more extensive development, manufacturing, marketing and other capabilities and a larger number of qualified managerial and technical personnel.
- *There is generally little or no publicly available information about our target tenants and borrowers.* Many of our tenants and borrowers are likely to be privately owned businesses, about which there is generally little or no publicly available operating and financial information. As a result, we will rely on our Adviser to perform due diligence investigations of these tenants and borrowers, their operations and their prospects. We may not learn all of the material information we need to know regarding these businesses through our investigations.
- *Small and medium-sized businesses generally have less predictable operating results.* We expect that many of our tenants and borrowers may have significant variations in their operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, may require substantial additional capital to support their operations, to finance expansion or to maintain their competitive positions, may otherwise have a weak financial position or may be adversely affected by changes in the business cycle. Our tenants and borrowers may not meet net income, cash flow and other coverage tests typically imposed by their senior lenders. The failure of a tenant or borrower to satisfy financial or operating covenants imposed by senior lenders could lead to defaults and, potentially, foreclosure on credit facilities, which could additionally trigger cross-defaults in other agreements. If this were to occur, it is possible that the ability of the tenant or borrower to make required payments to us would be jeopardized.
- *Small and medium-sized businesses are more likely to be dependent on one or two persons.* Typically, the success of a small or medium-sized business also depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of one or more of these persons could have a material adverse impact on our tenant or borrower and, in turn, on us.
- *Small and medium-sized businesses may have limited operating histories.* While we intend to target as tenants and borrowers stable companies with proven track records, we may lease properties or lend money to new companies that meet our other investment criteria. Tenants or borrowers with limited operating histories will be exposed to all of the operating risks that new businesses face and

may be particularly susceptible to, among other risks, market downturns, competitive pressures and the departure of key executive officers.

***Because we must distribute a substantial portion of our net income to qualify as a REIT, we will be largely dependent on third-party sources of capital to fund our future capital needs.***

To qualify as a REIT, we generally must distribute to our stockholders at least 90% of our taxable income each year, excluding capital gains. Because of this distribution requirement, it is not likely that we will be able to fund a significant portion of our future capital needs, including property acquisitions, from retained earnings. Therefore, we will likely have to rely on public and private debt and equity capital to fund our businesses. This capital may not be available on favorable terms or at all. Our access to additional capital depends on a number of things, including the market's perception of our growth potential and our current and potential future earnings. Moreover, additional debt financings may substantially increase our leverage.

***Our real estate portfolio will be concentrated in a limited number of properties, which subjects us to an increased risk of significant loss if any property declines in value or if we are unable to lease a property.***

We intend to purchase, or make mortgage loans secured by, an aggregate of approximately ten to fifteen properties with the proceeds of this offering. A consequence of a limited number of investments is that the aggregate returns we realize may be substantially adversely affected by the unfavorable performance of a small number of leases or mortgage loans or a significant decline in the value of any property. In addition, while we do not intend to invest 20% or more of our total assets in a particular property at the time of investment, it is possible that, as the values of our properties change, one property may comprise in excess of 20% of the value of our total assets. Lack of diversification will increase the potential that a single under-performing investment could have a material adverse effect on our cash flow and the price we could realize from the sale of our properties.

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

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

***Potential liability for environmental matters could adversely affect our financial condition.***

We intend to purchase industrial and commercial properties and will be subject to the risk of liabilities under federal, state and local environmental laws. Some of these laws could subject us to:

- responsibility and liability for the cost of removal or remediation of hazardous substances released on our properties, generally without regard to our knowledge of or responsibility for the presence of the contaminants;
- liability for the costs of removal or remediation of hazardous substances at disposal facilities for persons who arrange for the disposal or treatment of these substances; and
- potential liability for common law claims by third parties for damages resulting from environmental contaminants.

We will generally include provisions in our leases making tenants responsible for all environmental liabilities and for compliance with environmental regulations, and requiring tenants to reimburse us for damages or costs for which we have been found liable. However, these provisions will not eliminate our statutory liability or preclude third party claims against us and, even if we had a legal claim against a tenant to enable us to recover any amounts we are required to pay, there are no assurances that we would be able to collect any money from the tenant. Our costs of investigation, remediation or removal of hazardous substances may be substantial. In addition, the presence of hazardous substances on one of our

properties, or the failure to properly remediate a contaminated property, could adversely affect our ability to sell or lease the property or to borrow using the property as collateral.

***Our potential participation in joint ventures creates additional risk.***

We may participate in joint ventures or purchase properties jointly with other unaffiliated entities. There are additional risks involved in these types of transactions. These risks include the potential of our joint venture partner becoming bankrupt or our economic or business interests diverging. These diverging interests could, among other things, expose us to liabilities of the joint venture in excess of our proportionate share of these liabilities. The partition rights of each owner in a jointly owned property could reduce the value of each portion of the divided property.

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

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

**Risks Associated With Our Use of an Adviser to Manage Our Business**

***Our success will depend on the performance of our Adviser and you will not be able to evaluate the terms of our proposed investments.***

Our ability to achieve our investment objectives and to pay distributions to our stockholders is dependent upon the performance of our Adviser in evaluating potential investments selecting and negotiating property purchases and dispositions and mortgage loans, selecting tenants and borrowers, setting lease or loan terms and determining financing arrangements. You will have no opportunity to evaluate the terms of transactions or other economic or financial data concerning our investments. You must rely entirely on the analytical and management abilities of our Adviser and the oversight of our board of directors. If our Adviser or our board of directors makes inadvisable investment or management decisions, our operations could be materially adversely impacted.

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

Our Adviser will manage our business and will locate, evaluate, recommend and negotiate the acquisition of our real estate investments. At the same time, our advisory agreement permits our Adviser to conduct other commercial activities and provide management and advisory services to other entities, including Gladstone Land Corporation, an entity affiliated with our chairman David Gladstone. Moreover, our officers and directors are also officers and directors of Gladstone Capital Corporation, which actively makes loans to and invests in small and medium-sized companies. As a result, we may from time to time have conflicts of interest with our Adviser in its management of our business and with Gladstone Capital, which may arise primarily from the involvement of our Adviser, Gladstone Capital, Gladstone Land and their affiliates in other activities that may conflict with our business. Examples of these potential conflicts include:

- Our Adviser may realize substantial commissions, fees and other compensation on account of its activities on our behalf;
- Our agreements with our Adviser are not arm's-length agreements;
- We may experience competition with our affiliates for financing transactions;
- Our Adviser or its affiliates could acquire property adjacent to properties held by us; and

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

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

***Our financial condition and results of operations will depend on our Adviser's ability to effectively manage our future growth.***

Our ability to achieve our investment objectives will depend on our ability to sustain continued growth, which will, in turn, depend on our Adviser's ability to find, select and negotiate property purchases, net leases and mortgage loans that meet our investment criteria. Accomplishing this result on a cost-effective basis is largely a function of our Adviser's marketing capabilities, management of the investment process, ability to provide competent, attentive and efficient services and our access to financing sources on acceptable terms. As we grow, our Adviser may be required to hire, train, supervise and manage new employees. Our Adviser's failure to effectively manage our future growth could have a material adverse effect on our business, financial condition and results of operations.

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

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

**Risks Associated With Our Organizational Structure**

***The limit on the number of shares of common stock a person may own may discourage a takeover.***

Our articles of incorporation prohibit ownership of more than 9.8% of the outstanding shares of our common stock by one person. This restriction may discourage a change of control and may deter individuals or entities from making tender offers for our common stock, which offers might otherwise be financially attractive to our stockholders or which might cause a change in our management. See "Certain Provisions of Maryland Law and of our Articles of Incorporation and Bylaws — Restrictions on Ownership of Shares."

***Certain Provisions of Maryland law could restrict a change in control.***

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

- any person who beneficially owns 10% or more of the voting power of our common stock, referred to as an "interested stockholder;"
- an affiliate of ours who, at any time within the two-year period prior to the date in question, was an interested stockholder; or
- an affiliate of an interested stockholder.

These prohibitions last for five years after the most recent date on which the interested stockholder became an interested stockholder. Thereafter, any business combination with the interested stockholder must be recommended by our board of directors and approved by the affirmative vote of at least 80% of the votes entitled to be cast by holders of our outstanding shares of common stock and two-thirds of the votes entitled to be cast by holders of our common stock other than shares held by the interested stockholder. These requirements could have the effect of inhibiting a change in control even if a change in

control were in our stockholders' interest. These provisions of Maryland law do not apply, however, to business combinations that are approved or exempted by our board of directors prior to the time that someone becomes an interested stockholder.

***Our staggered director terms could deter takeover attempts and adversely impact the price of our common stock.***

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

**Tax Risks**

***We may not qualify as a REIT for federal income tax purposes, which would subject us to federal income tax on our taxable income at regular corporate rates, thereby reducing the amount of funds available for paying distributions to stockholders.***

We currently intend to operate in a manner that will allow us to qualify as a REIT for federal income tax purposes. Our qualification as a REIT will depend on our ability to meet various requirements set forth in the Internal Revenue Code concerning, among other things, the ownership of our outstanding common stock, the nature of our assets, the sources of our income and the amount of our distributions to our stockholders. The REIT qualification requirements are extremely complex, and interpretations of the federal income tax laws governing qualification as a REIT are limited. Accordingly, we cannot be certain that we will be successful in operating so as to qualify as a REIT. At any time new laws, interpretations or court decisions may change the federal tax laws relating to, or the federal income tax consequences of, qualification as a REIT. It is possible that future economic, market, legal, tax or other considerations may cause our board of directors to revoke our REIT election, which it may do without stockholder approval.

If we lose or revoke our REIT status, we will face serious tax consequences that will substantially reduce the funds available for distribution to you because:

- we would not be allowed a deduction for distributions to stockholders in computing our taxable income, we would be subject to federal income tax at regular corporate rates and we might need to borrow money or sell assets in order to pay any such tax;
- we also could be subject to the federal alternative minimum tax and possibly increased state and local taxes; and
- unless we are entitled to relief under statutory provisions, we would be disqualified from taxation as a REIT for the four taxable years following the year during which we ceased to qualify.

In addition, if we fail to qualify as a REIT, all distributions to stockholders would be subject to tax to the extent of our current and accumulated earnings and profits, provided that the rate of tax on the taxable portion of such distributions is limited to 15% through 2008. If we were taxed as a regular corporation, we would not be required to make distributions to stockholders and corporate distributees might be eligible for the dividends received deduction.

As a result of all these factors, our failure to qualify as a REIT could impair our ability to expand our business and raise capital, and would adversely affect the value of our common stock.



***Failure to make required distributions would subject us to tax.***

In order to qualify as a REIT, each year we must distribute to our stockholders at least 90% of our taxable income, other than any net capital gains. To the extent that we satisfy the distribution requirement but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed income. In addition, we will incur a 4% nondeductible excise tax on the amount, if any, by which our distributions in any year are less than the sum of:

- 85% of our ordinary income for that year;
- 95% of our capital gain net income for that year; and
- 100% of our undistributed taxable income from prior years.

We intend to pay out our income to our stockholders in a manner intended to satisfy the distribution requirement applicable to REITs and to avoid corporate income tax and the 4% excise tax. Differences in timing between the recognition of income and the related cash receipts or the effect of required debt amortization payments could require us to borrow money or sell assets to pay out enough of our taxable income to satisfy the distribution requirement and to avoid corporate income tax and the 4% excise tax in a particular year. In the future, we may borrow funds to pay distributions to our stockholders and the limited partners of our Operating Partnership. Any funds that we borrow would subject us to interest rate and other market risks.

***There are special considerations for pension or profit-sharing trusts, Keogh Plans or individual retirement accounts whose assets are being invested in our common stock.***

If you are investing the assets of a pension, profit sharing, 401(k), Keogh or other retirement plan, IRA or benefit plan in us, you should consider:

- whether your investment is consistent with the applicable provisions of the Employee Retirement Income Security Act (ERISA) or the Internal Revenue Code;
- whether your investment will produce unrelated business taxable income, referred to as UBTI, to the benefit plan; and
- your need to value the assets of the benefit plan annually.

We do not believe that under current ERISA law and regulations that our assets would be treated as “plan assets” for purposes of ERISA. However, if our assets were considered to be plan assets, our assets would be subject to ERISA and/or Section 4975 of the Internal Revenue Code, and some of the transactions we have entered into with our Adviser and its affiliates could be considered “prohibited transactions” which could cause us, our Adviser and its affiliates to be subject to liabilities and excise taxes. In addition, our officers and directors, our Adviser and its affiliates could be deemed to be fiduciaries under ERISA and subject to other conditions, restrictions and prohibitions under Part 4 of Title I of ERISA. Even if our assets are not considered to be plan assets, a prohibited transaction could occur if we or any of our affiliates is a fiduciary (within the meaning of ERISA) with respect to a purchase by a benefit plan and, therefore, unless an administrative or statutory exemption applies in the event such persons are fiduciaries (within the meaning of ERISA) with respect to your purchase, shares should not be purchased.

**Risks Relating to this Offering and the Market for our Common Stock**

***The market price and trading volume of our common stock may be volatile following this offering.***

Even if an active trading market develops for our common stock after this offering, the market price of our common stock may be highly volatile and subject to wide fluctuations. In addition, the trading volume in our common stock may fluctuate and cause significant price variations to occur. If the market price of our common stock declines significantly, you may be unable to resell your shares at or above the initial public offering price. We cannot assure you that the market price of our common stock will not

fluctuate or decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our common stock include:

- price and volume fluctuations in the stock market from time to time, which are often unrelated to the operating performance of particular companies;
- significant volatility in the market price and trading volume of shares of REITs, real estate companies or other companies in our sector, which is not necessarily related to the performance of those companies;
- price and volume fluctuations in the stock market as a result of terrorist attacks, or speculation regarding future terrorist attacks, in the United States or abroad;
- price and volume fluctuations in the stock market as a result of involvement of the United States in armed hostilities, or uncertainty regarding United States involvement in such activities;
- actual or anticipated variations in our quarterly operating results or dividends;
- changes in our funds from operations or earnings estimates or the publication of research reports about us or the real estate industry generally;
- increases in market interest rates that lead purchasers of our shares of common stock to demand a higher yield;
- changes in market valuations of similar companies;
- adverse market reaction to our anticipated level of debt or any increased indebtedness we incur in the future;
- additions or departures of key management personnel;
- actions by institutional stockholders;
- speculation in the press or investment community;
- changes in regulatory policies or tax guidelines, particularly with respect to REITs;
- loss of REIT status for federal income tax purposes;
- loss of a major funding source; and
- general market and economic conditions.

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

We cannot predict the effect, if any, of future sales of common stock, or the availability of shares for future sales, on the market price of our common stock. Sales of substantial amounts of common stock (including shares of common stock issuable upon the conversion of units of our operating partnership that we may issue from time to time, the sale of up to 52,000 shares of common stock held by David Gladstone, and the issuance of up to 625,000 shares reserved for issuance upon the exercise of options to be granted under our 2003 Equity Incentive Plan), or the perception that these sales could occur, may adversely affect prevailing market prices for our common stock.

***Terrorist attacks and other acts of violence or war may affect the market on which our shares trade, the markets in which we operate, our operations and our profitability.***

Terrorist attacks, such as the attacks that occurred in New York and Washington, D.C. on September 11, 2001, may negatively affect our operations and your investment in our common stock. We cannot assure you that there will not be further terrorist attacks against the United States or United States businesses. Some of our properties are likely to be in prominent locations, or located in areas that may be susceptible to attack, which may make these properties more likely to be viewed as terrorist targets than similar properties in less prominent locations. These attacks or armed conflicts may directly impact the

value of our properties through damage, destruction, loss or increased security costs. Certain losses resulting from these types of events are uninsurable and others are not likely to be covered by our insurance.

The United States recently entered into an armed conflict with Iraq, and may enter into additional armed conflicts in the future. The consequences of any armed conflicts are unpredictable, and we may not be able to foresee events that could have an adverse effect on our business.

Any of these events could result in increased volatility in or damage to the United States and worldwide financial markets and economy. They also could result in a continuation of the current economic uncertainty in the United States or abroad. Adverse economic conditions could affect the ability of our tenants to pay rent and of our borrowers to make their mortgage payments, which could have a material adverse effect on our operating results and financial condition, as well as our ability to pay dividends to our stockholders, and may result in volatility in the market price for our common stock.

***An increase in market interest rates may have an adverse effect on the market price of our common stock.***

One of the factors that investors may consider in deciding whether to buy or sell our common stock is our dividend rate as a percentage of our share price, relative to market interest rates. If market interest rates increase, prospective investors may desire a higher dividend yield on our common stock or seek securities paying higher dividends or interest. The market price of our common stock likely will be based primarily on the earnings that we derive from rental income with respect to our properties, interest earned on our mortgage loans and our related distributions to stockholders, and not from the underlying appraised value of the properties themselves. As a result, interest rate fluctuations and capital market conditions are likely to affect the market price of our common stock, and such effects could be significant. For instance, if interest rates rise without an increase in our dividend rate, the market price of our common stock could decrease because potential investors may require a higher dividend yield on our common stock as market rates on interest-bearing securities, such as bonds, rise.

## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

We make forward-looking statements in this prospectus that are subject to risks and uncertainties. These forward-looking statements include information about 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;
- our projected operating results;
- our ability to obtain future financing arrangements;
- estimates relating to our future distributions;
- our understanding of our competition;
- market trends;
- projected capital expenditures; and
- use of the proceeds of this offering.

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. 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 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 factors referenced in this prospectus, including those set forth under the section captioned “Risk Factors;”
- general volatility of the capital markets and the market price of our common stock;
- changes in our business strategy;
- availability, terms and deployment of capital;
- availability of qualified personnel;
- changes in our industry, interest rates or the general economy; and
- the degree and nature of our competition.

## USE OF PROCEEDS

We estimate that the net proceeds of this offering will be approximately \$60.7 million (\$71.5 million if the underwriters exercise their over-allotment option in full) after deducting the underwriting discount and estimated offering expenses payable by us. We expect to use the net proceeds of this offering to buy commercial and industrial real estate for lease to tenants, to make industrial and commercial mortgage loans and to reimburse our Adviser for the expenses and fees it incurs in connection with our business. As of the date of this prospectus, we do not have commitments to purchase any properties or make any loans. We will invest the net proceeds in accordance with our investment objectives and policies. See “Investment Policies and Policies with Respect to Certain Activities” for additional information regarding our investment objectives and policies. We estimate that it will take approximately 18 months for us to substantially invest the net proceeds of this offering, depending on the availability of appropriate opportunities and market conditions. Pending such investment, we will primarily invest the net proceeds in REIT-qualified money market instruments, short-term repurchase agreements or other cash equivalents that are expected to provide a lower net return than we hope to achieve from our intended real estate investments. We may also temporarily invest in securities that qualify as “real estate assets” under the REIT provisions of the Internal Revenue Code, such as mortgage-backed securities. There can be no assurance that we will be able to achieve our targeted investment pace. See “Investment Policies and Policies with Respect to Certain Activities — Additional Investment Considerations — Temporary Investments” for additional information about temporary investments we may make while waiting to make real estate investments.

## DIVIDEND POLICY

We intend to distribute substantially all of our taxable income each year (which does not ordinarily equal net income as calculated in accordance with United States generally accepted accounting principles) to our stockholders so as to comply with the REIT provisions of the Internal Revenue Code. We intend to make quarterly distributions to our stockholders beginning within 120 days after we complete this offering. Our distribution policy is subject to revision at the discretion of our board of directors. Our board of directors will determine the amount of any distributions and such amount will depend on our capital needs, our taxable earnings, our financial condition, our annual distribution requirements to maintain REIT status and such other factors as our board of directors deems relevant.

Distributions to our stockholders will generally be subject to tax as ordinary income, although we may designate a portion of such distributions as capital gain and a portion may constitute a tax-free return of capital. We will furnish to each of our stockholders annually a statement setting forth distributions paid during the preceding year and their characterization as ordinary income, capital gains or return of capital.

We have adopted a dividend reinvestment plan that allows holders of our common stock to have their distributions reinvested automatically in additional shares of our common stock. For more information, see “Dividend Reinvestment Plan.”

## CAPITALIZATION

The following table sets forth our actual capitalization at March 31, 2003 on a historical basis and as adjusted to give effect to (1) the payment by David Gladstone to us of \$42,000 in satisfaction of a stock subscription receivable as of June 10, 2003 and (2) the sale of our common stock offered in this offering at an assumed public offering price of \$15.00. This table should be read in conjunction with "Use of Proceeds" and our audited balance sheet included elsewhere in this prospectus.

	Actual	As adjusted
		(Unaudited)
Stockholders' equity:		
Common stock, \$0.001 par value per share; 20,000,000 shares authorized, 52,000 shares outstanding, actual; 20,000,000 shares authorized, 4,472,000 shares outstanding, as adjusted	\$ 52	\$ 4,472
Additional paid-in capital	51,948	60,706,528
Stock subscription receivable	(42,000)	—
Retained deficit	(10,549)	(10,549)
Total stockholders' equity (deficit)	\$ (549)	\$60,700,451

## DILUTION

The calculations below give effect to (1) the payment by David Gladstone to us of \$42,000 as of June 10, 2003 in satisfaction of a stock subscription receivable and (2) assume no exercise of the underwriters' over-allotment option. The calculations below also assume no exercise of any outstanding options to be granted under our 2003 Equity Incentive Plan.

Our net tangible book value as adjusted at March 31, 2003 was \$41,451, or \$.80 per share of common stock. Net tangible book value per share represents our total tangible assets minus our total liabilities, divided by the number of shares of common stock outstanding as of that date.

After giving effect to the net proceeds from the sale of shares of common stock in this offering at an assumed initial public offering price of \$15.00 per share, our pro forma net tangible book value at March 31, 2003 would have been approximately \$60.7 million or \$13.57 per share of common stock. This represents an immediate increase in net tangible book value of \$12.77 per share to existing stockholders and immediate dilution of \$1.43 per share to new investors purchasing shares in this offering at an assumed offering price equal to \$15.00 per share.

The following table illustrates this dilution in net tangible book value on a per-share basis:

Initial public offering price per share	\$15.00
Net tangible book value per share as of March 31, 2003 as adjusted	\$ .80
Increase attributable to the sale of shares offered hereby	\$12.77
Adjusted net tangible book value after this offering	\$13.57
Dilution in the net tangible book value to new investors	\$ 1.43

The following table summarizes on a pro forma basis at March 31, 2003 the total consideration and the average price per share of common stock paid by (1) the existing stockholder, David Gladstone, and (2) the purchasers in this offering:

	Shares Purchased		Total Consideration		Average Price Per Share
	Number	Percent	Amount	Percent	
Existing stockholders	52,000	1.16%	\$ 52,000	0.08%	\$ 1.00
New investors	4,420,000	98.84%	\$66,300,000	99.92%	\$ 15.00
<b>Total</b>	<b>4,472,000</b>	<b>100%</b>	<b>\$66,352,000</b>	<b>100%</b>	<b>\$ 14.84</b>

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*We are a newly incorporated company and have only recently commenced operations. Therefore, we do not have any meaningful operations to discuss. Please see "Risk Factors — We are a new company with no operating history and may not be able to operate successfully" for a discussion of risks relating to our lack of historical operations. The following analysis of our financial condition should be read in conjunction with our financial statements and the notes thereto and the other financial data included elsewhere in this prospectus.*

**Overview**

We were incorporated under the General Corporation Laws of the State of Maryland on February 14, 2003 primarily for the purpose of investing in and owning net leased industrial and commercial real property and making long-term industrial and commercial mortgage loans. We expect that most of our tenants and borrowers will be small and medium-sized businesses that have significant buyout fund ownership and will be well capitalized. Although we have not yet purchased any properties or made any loans, we are actively seeking and evaluating potential properties for acquisition.

We will conduct substantially all of our activities through, and substantially all of our properties will be 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 will control our Operating Partnership as its sole general partner and will also initially 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 after the first anniversary of the completion of this offering. 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 us and its limited partners 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 quarterly cash dividends. We intend 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.

**Critical Accounting Policies**

Management believes our most critical accounting policies are the accounting for lease revenues (including straight-line rent), provision for loans losses, the regular evaluation of whether the value of a real estate asset has been impaired and the accounting for our derivatives and hedging activities, if any. Each of these items involve 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.

***Revenue Recognition***

Our revenues, which will be derived primarily from rental income, will 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. Since our leases may provide for rental increases at specified intervals, straight-line basis accounting will require us to record as an asset, and include in revenues, unbilled rent that we will only receive if the tenant makes all rent payments required through the expiration of the initial term of the lease. Accordingly, our management must determine, in its judgment, to what extent the unbilled rent receivable applicable to each specific tenant is collectible. We will review unbilled 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 unbilled rent with respect to any given tenant is in doubt, we would be required to 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.

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

We will record investments in real estate at cost and we will capitalize improvements and replacements when they extend the useful life or improve the efficiency of the asset. We will expense costs of repairs and maintenance as incurred. We will compute depreciation using the straight-line method over the estimated useful life of 40 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 will be 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 will 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 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which established a single accounting model for the impairment or disposal of long-lived assets including discontinued operations. SFAS 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 will review the recoverability of the property's carrying value. The review of recoverability will be 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 will consider 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 will be recorded to the extent that the carrying value exceeds the estimated fair value of the property. We will be required to make subjective assessments as to whether there are impairments in the values of our investments in real estate.

#### ***Accounting for Derivative Financial Investments and Hedging Activities***

We will account for our derivative and hedging activities, if any, using SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 137 and SFAS 149, 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 133. We are not currently party to any derivatives.

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

Our accounting policies require that we reflect in our financial statements an allowance for estimated credit losses with respect to loans we have made based upon our evaluation of known and inherent risks associated with our private lending assets. While we have not yet made any loans and therefore have not experienced any actual losses in connection with our lending investments, management considers it prudent, once we have made loans, to reflect 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.

#### ***Income Taxes***

Our financial results generally do not reflect provisions for current or deferred income taxes. Management believes that we will operate in a manner that will allow us to be taxed 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.

#### **Financial Condition, Liquidity and Capital Resources**

We are dependent upon the net proceeds to be received from this offering to conduct our proposed activities. The capital required to purchase properties and make loans will be obtained from this offering and from any indebtedness that we may incur in connection with the acquisition of any properties thereafter. We have been initially capitalized with \$52,000 from the sale of 52,000 shares of common stock to David Gladstone, our chairman and chief executive officer. We currently have no commitments to acquire any property or to make any other material expenditure. For information concerning the anticipated use of the net proceeds from this offering, see "Use of Proceeds."

Our sources of funds will primarily be the net proceeds of this offering, operating cash flows and borrowings. Immediately after this offering (assuming no exercise of the underwriters' over-allotment option), we expect to have cash resources in excess of \$60 million and no indebtedness.

Any indebtedness we incur will likely be subject to continuing covenants, and we will likely be required to make continuing representations and warranties about our company in connection with such debt. Moreover, some or all of our debt may be secured by some or all of our assets. If we default in the payment of interest or principal on any such debt, breach any representation or warranty in connection with any borrowing or violate any covenant in any loan document, our lender may accelerate the maturity of such debt requiring us to immediately repay all outstanding principal. If we are unable to make such payment, our lender could foreclose on our assets that are pledged as collateral to such lender. The lender could also sue us or force us into bankruptcy. Any such event would likely have a material adverse effect on the value of an investment in our common stock.

We intend to begin making quarterly distributions to our stockholders within 120 days after we complete this offering. In order to qualify as a REIT and to avoid corporate-level tax on the income we distribute to our stockholders, we are required to distribute at least 90% of our ordinary income and short-term capital gains on an annual basis. Therefore, once the net proceeds we receive from this offering are substantially fully invested, we will need to raise additional capital in order to grow our business and acquire additional properties. We anticipate borrowing funds to obtain additional capital once the proceeds of this offering have been fully invested, but there can be no assurance that we will be able to do so on terms acceptable to us, if at all. For additional information regarding our distribution policies and

requirements and our strategy of borrowing funds following the application of the proceeds from this offering, see “Dividend Policy” and “Investment Policies and Policies with Respect to Certain Activities — Use of Leverage.”

## GLADSTONE COMMERCIAL CORPORATION

### Overview

We were formed under the General Corporation Laws of the State of Maryland on February 14, 2003 with perpetual existence and primarily for the purpose of investing in and owning net leased industrial and commercial real property and making long-term mortgage loans. Our Adviser, Gladstone Management Corporation, serves as our external adviser and manages our business. We expect that most of our tenants and borrowers will consist of small and medium-sized businesses having significant buyout fund ownership and will be well capitalized. Although we have not yet purchased any properties or made any loans, we are actively seeking and evaluating properties for potential acquisition or mortgage financing.

We intend to qualify as, and be taxed as, a REIT. Our executive offices are located at 1750 Tysons Blvd., Fourth Floor, McLean, Virginia 22102. Our phone number is (703) 744-1165 and our internet website address will be [www.GladstoneCommercial.com](http://www.GladstoneCommercial.com). The information on our website is not a part of this prospectus.

### OUR OPPORTUNITY

Businesses that have been acquired or recapitalized by buyout funds and many family-owned businesses often have substantial amounts of equity in their real estate. A primary reason for this is that real estate lenders have been making real estate loans at relatively low amounts when compared to the value of the real estate securing the loans. One method for these businesses to free up the equity in their real estate is by selling their real estate and simultaneously leasing it back under long term, triple net leases. Sellers in these “sale-leaseback” transactions can then use the freed up cash to repay existing indebtedness or for growth capital, thus strengthening their balance sheets and permitting them to lower their overall costs of capital for growth and expansion. We believe that there are many businesses in the United States that have a substantial amount of equity tied up in their real estate. Because of the experience of our Adviser’s professionals investing in real estate-related assets and managing funds that lend to similar businesses, we believe our Adviser is uniquely positioned to identify and evaluate these sale-leaseback opportunities and to negotiate attractive investments for us. We also believe there are a substantial number of businesses that would not be interested in a sale-leaseback transaction, but would benefit from refinancing their current real estate mortgage loans. To address this need, we will also offer long-term mortgage loans on competitive terms and conditions.

### OUR BUSINESS STRATEGY

Our principal investment objectives are to generate income for distribution to our stockholders in the form of quarterly cash dividends that grow over time and to increase the value of our common stock. Our primary strategy to achieve our investment objectives is to utilize the substantial knowledge and experience of our Adviser’s professionals in financing small and medium-sized businesses so as to own a diversified portfolio of leased commercial and industrial real estate and make industrial and commercial mortgage loans that we believe will generate stable cash flow and increase in value. To achieve our investment objectives, we intend to:

- acquire properties at prices our Adviser believes are favorable;
- lease industrial and commercial properties or extend mortgage loans to creditworthy businesses;
- use non-recourse borrowing to maximize the return to our stockholders while limiting our loss exposure on any property to the amount of equity invested in the property;

- increase the equity value in our real estate through regular mortgage principal payments;
- obtain equity interests in certain tenants;
- participate in joint ventures that will permit us to own interests in large properties without restricting the diversity of our portfolio; and
- sell real estate assets from time to time at favorable prices.

There can be no assurance that all or any of these strategies will be effective or that we will achieve our investment objectives.

## **INVESTMENT POLICIES AND POLICIES WITH RESPECT TO CERTAIN ACTIVITIES**

### **Types of Investments**

#### ***Overview***

Once we have invested the net proceeds of this offering, we intend that substantially all of our investments will be income-producing real property or mortgage loans. We anticipate that acquired property will be either improved or, if under development, near completion. Investments will not be restricted as to geographical areas, but we expect that all of our investments in real estate will be made within the United States. Prospective investors will not be afforded the opportunity to evaluate the merits of our investments or the terms of any dispositions of properties. See “Risk Factors — Our success will depend on the performance of our Adviser and you will not be able to evaluate the terms of our proposed investments.”

We anticipate that we will make substantially all of our investments through our Operating Partnership. Our Operating Partnership may acquire interests in real property or mortgage loans in exchange for the issuance of limited partnership units, for cash or through a combination of both. Units issued by our Operating Partnership will be redeemable for cash or, at our election, shares of our common stock on a one-for-one basis at any time after the first anniversary of the completion of this offering. However, we may in the future also conduct some of our business and hold some of our interests in real properties or mortgage loans through one or more wholly owned subsidiaries, each classified as a “qualified REIT subsidiary.” See “Federal Income Tax Consequences of our Status as a REIT—Requirements for Qualification.”

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

We anticipate that a majority of the properties we purchase will be acquired from companies that will simultaneously lease the properties back from us. These sale-leaseback transactions will provide the tenants with an alternative to other financing sources such as corporate borrowing, mortgaging real property, or selling securities. We anticipate that some of our sale-leaseback transactions will be in conjunction with acquisitions, recapitalizations or other corporate transactions affecting our tenants. We may act as one of several sources of financing for these transactions by purchasing one or more properties from the tenant and by net leasing it to the tenant or its successor in interest. For a discussion of the risks associated with leasing property to leveraged tenants, see “Risk Factors — Highly leveraged tenants or borrowers may be unable to pay rent or make loan payments, which could adversely affect our cash available to pay dividends.”

In some circumstances, we may grant a tenant an option to purchase the property that the tenant leases from us. In these cases, we would generally seek to fix the option purchase price at the greater of our purchase price for the property and the fair market value of the property at the time the option is exercised.

We intend to own primarily single-tenant commercial and industrial real property, either existing or under construction. Generally, we will lease properties to tenants that our Adviser deems creditworthy

under leases that will be full recourse obligations of our tenants or their affiliates. In most cases, the leases will be “net leases” that require the tenant to pay all the operating costs, costs of maintenance, insurance and real estate taxes on the property. All of our leases will be approved by our Adviser’s investment committee and our board of directors.

### ***Investments in mortgage loans***

We may elect to structure our investment in a particular property as a mortgage loan secured by the property in situations where a standard net lease transaction would have an adverse impact on the seller of a property or would otherwise be inappropriate for us. We anticipate that most of our lending transactions will be loans secured by industrial or commercial property. Our Adviser will attempt to structure loans in a manner that would provide us with an economic return similar to that which we could expect to receive had the investment been structured as a net lease transaction. All of our mortgage loans will be approved by our Adviser’s investment committee and by our board of directors.

## **Underwriting Criteria and Due Diligence Process**

### ***Underwriting of the Tenant or Borrower***

We consider underwriting the tenant for the property (or the borrower of a mortgage loan) to be the most important aspect of making an investment. Evaluating the creditworthiness of the tenant or borrower and its ability to generate sufficient cash flow to make payments to us pursuant to the lease or the mortgage loan is the most important aspect of our underwriting procedures. The following is a list of criteria that our Adviser will consider when underwriting leases and loans on our behalf (all criteria may not be present for each lease or loan that we make):

- property that is a necessary part of the tenant’s operations;
- tenants or borrowers with annual revenue of \$25 to \$500 million or more;
- property acquisition cost or value between \$3 million and \$15 million;
- tenants or borrowers with demonstrated profitability and cash flow or that plan to achieve profitability consistent with our underwriting criteria;
- tenants or borrowers with earnings between 2 and 3.5 times lease payments or greater;
- tenants or borrowers with a risk rating on our ten-point risk rating scale (described below) of at least 4, which approximates a B- credit rating from national credit ratings agencies;
- triple net lease structures in which the tenant will be responsible for the maintenance, insurance, taxes, and other operating costs on the property;
- leases with annual rent increases, such as cost of living adjustments;
- tenants with bank lending relationships in place and that are on good terms with their lenders;
- tenants or borrowers that have significant buyout fund ownership;
- property that has had a Member Appraisal Institute, or MAI, appraisal that is not substantially below our purchase price; and
- property that has been screened for alternative uses.

In analyzing potential acquisitions of properties, our Adviser will review all aspects of the potential transaction, including tenant and real estate fundamentals, to determine whether a potential acquisition and lease can be structured to satisfy our acquisition criteria. Our Adviser will also consider the following factors when evaluating a potential sale-leaseback transaction:

- *Tenant Evaluation.* Our Adviser will evaluate each potential tenant for its creditworthiness, considering factors such as management experience, industry position and fundamentals, operating

history and capital structure. Whether or not a prospective tenant is creditworthy will be determined by our Adviser. A prospective tenant that is creditworthy does not necessarily mean that we will consider the tenant's property to be "investment grade." Our Adviser will seek tenants that are small or medium-sized businesses, that have received significant financing from buyout funds and that it believes will have stable or improving credit profiles. We believe that there is currently a shortage of capital available for tenants with these types of credit profiles. Our Adviser's investment professionals, including Messrs. Gladstone, Brubaker and Stelljes, have substantial experience in locating and financing these types of companies. By leasing properties to these tenants, we believe that we will generally be able to charge rent that is higher than the rent charged to tenants with unleveraged balance sheets and recognized credit, thereby enhancing current return from these properties as compared with properties leased to companies whose credit potential has already been recognized by the market. Furthermore, if a tenant's credit does improve, the value of our lease or investment will likely increase (if all other factors affecting value remain unchanged).

- *Leases with Increasing Rent.* Our Adviser will seek to include a clause in each lease that provides for increases in rent over the term of the lease. These increases will be fixed or will be tied generally to increases in indices such as the consumer price index.
- *Diversification.* Our Adviser will attempt to diversify our portfolio to avoid dependence on any one particular tenant, facility type, geographic location or tenant industry. By diversifying our portfolio, our Adviser intends to reduce the adverse effect on our portfolio of a single under-performing investment or a downturn in any particular industry or geographic region.
- *Property Valuation.* The business prospects for the tenant and the financial strength of the tenant will be an important aspect of the evaluation of any sale and leaseback of property, particularly a property that is specifically suited to the needs of the tenant. We will generally require monthly unaudited and annual audited financial statements of the tenant in order to continuously monitor performance of the property, and evaluate the financial capability of the tenant and its ability to perform the terms of the purchase and leaseback agreement. Where appropriate, we will also examine the available operating results of prospective investment properties to determine whether or not projected rental levels are likely to be met. We will then compute the value of the property based on historical and projected operating results and will evaluate the potential for value appreciation in such property.
- *Properties Important to Tenant Operations.* Our Adviser will generally seek to acquire investment properties that are essential or important to the ongoing operations of the prospective tenant. We believe that these investment properties provide better protection in the event a tenant becomes bankrupt, since leases on properties essential or important to the operations of a bankrupt tenant are generally less likely to be rejected in the bankruptcy or otherwise terminated.
- *Lease Provisions that Enhance and Protect Value.* When appropriate, our Adviser will attempt to include provisions in our leases that require our consent to specified tenant activity or require the tenant to satisfy specific operating tests. These provisions may include, for example, operational or financial covenants of the tenant, as well as indemnification of us by the tenant against environmental and other contingent liabilities. We believe that these provisions will protect our investments from changes in the operating and financial characteristics of a tenant that may impact its ability to satisfy its obligations to us or that could reduce the value of our properties. We will also seek covenants requiring tenants to receive our consent prior to any change in control of the tenant.
- *Letter of Credit or Guaranty.* Our Adviser may also seek to enhance the likelihood of a tenant's lease obligations being satisfied through a letter of credit or a guaranty of lease obligations from each tenant's corporate parent. We believe that this credit enhancement will provide us with additional financial security. In evaluating a possible investment, we believe that the creditworthiness of a prospective tenant generally will be a more significant factor than the unleased value of the property itself. While our Adviser will select tenants it believes to be creditworthy, tenants will

not be required to meet any minimum rating established by an independent credit rating agency. Our Adviser's standards for determining whether a particular tenant is creditworthy will vary in accordance with a variety of factors relating to specific prospective tenants. The creditworthiness of a tenant will be determined on a tenant by tenant and case by case basis. Therefore, general standards for creditworthiness cannot be applied.

Our Adviser will use a variety of other evaluation and negotiating strategies in connection with its prospective acquisitions. These strategies will include attempting to obtain equity enhancements, such as warrants to purchase stock of the tenant or its parent company. We believe that, if the value of the underlying stock exceeds the exercise price of the warrant, these equity enhancements will help us to achieve our goal of increasing funds available for the payment of dividends to our stockholders. We may also negotiate for success fees that would be payable to us in the event of a change in control of the tenant or its parent company as another way of enhancing our return on a particular investment.

Each property that we propose to purchase will be appraised by an independent appraiser. These appraisals may take into consideration, among other things, the terms and conditions of the particular lease transaction, the quality of the tenant's credit and the conditions of the credit markets at the time the lease transaction is negotiated. The appraised value may be greater than the construction cost or the replacement cost of a property, and the actual sale price of a property, if sold by us, may be greater or less than its appraised value.

### ***Risk Rating System***

In evaluating each transaction that it considers for investment, our Adviser will assign 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%
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.

As stated above, we generally anticipate entering into transactions that have a risk rating of at least 4 based on the above scale. Once we have entered into a transaction, we will periodically re-evaluate the risk rating of the investment for purposes of determining whether we should increase our reserves for loan losses or allowance for uncollectible rent. Our board of directors may alter our risk rating system from time to time.

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

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

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



Our Adviser will also physically inspect the real estate and surrounding real estate in order to determine the value of the real estate. All of our Adviser's due diligence will be aimed at arriving at a valuation of the real estate if it was not rented to the tenant we are considering. The real estate valuations our Adviser performs will consider one or more of the following items, but may not consider all of them:

- The comparable value of similar real estate in the same general area of the prospective property. In this regard, comparable property is hard to define since each piece of real estate has its own distinct characteristics. But to the extent possible, comparable property in the area that has sold or is for sale will be used to determine if the price being paid for the property is reasonable. The question of comparable properties' sale prices is particularly relevant if a property might be sold at a later date.
- The comparable real estate rental rates for similar properties in the same area of the prospective property.
- Alternative uses for the property in order to determine if there is another use for the property that would give it higher value.
- The cost of replacing the property if it were to be sold for the replacement value.
- The assessed value as determined by the local real estate taxing authority.

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

#### **Additional Investment Considerations**

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

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

Except as described below, any loan in our portfolio will be secured by a first priority mortgage or deed of trust on industrial or commercial property as well as a security interest in personal or mixed property connected with the real property. The loan generally will be secured by property with a demonstrable income-producing potential. In determining whether to make a loan, our Adviser will analyze relevant property and financial factors which may include the condition and use of the subject property, its income-producing capacity and the quality, experience and creditworthiness of the borrower.

In the event that we make or invest in a loan, we will generally require a mortgagee's title insurance policy or commitment as to the lien priority of a mortgage or the condition of title in connection with each loan. We will obtain an independent appraisal for underlying real property, although our Adviser generally will rely on its own independent analysis and not exclusively on an appraisal in determining whether or not to make or invest in a particular loan. We believe that appraisals are merely estimates of value and should not be relied upon exclusively as measures of true worth or realizable value. In making loans that, when combined with existing loans that are on a parity with or senior to our loan, exceed 85% of the appraised value of any underlying real property, our Adviser will consider additional underwriting criteria such as the net worth of the borrower, the borrower's credit rating, if any, the anticipated cash flow of the borrower, any additional collateral or other credit enhancements provided by the borrower or its affiliates and other factors our Adviser deems appropriate. Where we think it is appropriate we will make loans that are subordinated to a first mortgage on a property. For example, if the property is subject to an economic

development loan as a first mortgage at a particularly low interest rate, we may make a second mortgage loan on the property. However, we will not make second mortgage loans on any property that we would not consider owning and leasing to the tenant.

From time to time, we may purchase mortgages loans, including loans being sold at a discount, from banks and other financial institutions if the subject property otherwise satisfies our underwriting criteria. We may also make loans to our wholly-owned subsidiaries, if any, as our Adviser deems appropriate, and we may guarantee the obligations of these subsidiaries.

### ***Other Investments***

We may invest up to an aggregate of 10% of our net equity in unimproved or non-income-producing real property and in “equity interests.” We anticipate that equity interests will not exceed 5% of our net equity in the aggregate, and we will not make any such investment in equity interests if such investment would adversely affect our qualification as a REIT. “Equity interests” are defined generally to mean stock, warrants or other rights to purchase the stock of, or other equity interests in, a tenant of a property, an entity to which we lend money or a parent or controlling person of a borrower or tenant. To the extent that we hold equity interests in tenants or borrowers, we anticipate that they will generally be “restricted securities” as defined in Rule 144 under the Securities Act of 1933. Under this rule, we may be prohibited from reselling the equity securities without limitation until we have fully paid for and held the securities for two years. The issuer of equity interests in which we invest may never register these interests under the federal securities laws, since the decision of an issuer to register its securities may depend on the success of its operations.

To the extent we receive warrants or other rights to purchase stock in connection with our investments in properties, we will exercise these rights only if the value of the underlying stock at the time the rights are exercised exceeds the exercise price of the right. Payment of the exercise price would not be deemed an investment that would be subject to the above described limitations. We may borrow funds to pay the exercise price on warrants or other rights or may pay the exercise price from funds held for working capital and then repay the loan or replenish the working capital upon the sale of the securities or interests purchased. We will not pay distributions to stockholders out of the proceeds of the sale of any equity interests until any funds borrowed to purchase the equity interests have been fully repaid. We will invest in equity interests which our Adviser believes will appreciate in value. There can be no assurance, however, that this expectation will be realized.

We will generally invest in unimproved or non-income-producing property only when our Adviser believes that such property will appreciate in value or will increase the value of an adjoining or neighboring property that we own. There can be no assurance that these expectations will be realized.

We might use taxable REIT subsidiaries to acquire or hold property, including equity interests, that are not REIT-qualified assets. Taxable REIT subsidiaries are taxed as ordinary corporations. Taxes paid by any taxable REIT subsidiary will reduce cash available to us for payment of distributions to our stockholders.

### ***Temporary Investments***

There can be no assurance as to when our capital may be fully invested in real properties and mortgage loans. Pending investment in real properties or mortgage loans, we intend to invest the balance of the proceeds of this offering in permitted temporary investments, which include short-term U.S. Government securities, bank certificates of deposit and other short-term liquid investments. We also may invest in securities that qualify as “real estate assets” and produce qualifying income under the REIT provisions of the Internal Revenue Code.

We may purchase interests in mortgage-backed securities, including mortgage pass-through certificates, collateralized mortgage obligations and other securities representing interests in, or obligations backed by, pools of mortgage loans. Mortgage-backed securities represent interests in cash flows from

mortgage loans or interests in other mortgage-backed securities. The securities are often sold in tranches representing at least two rated securities which are usually “AAA” and “A,” and at least one unrated security. We may purchase either rated or unrated securities. To the extent we purchase mortgage-backed securities, we will use the same investment guidelines as if we were purchasing the loans or real estate underlying these securities. That is, we will seek to generate net income for distribution to our stockholders from the spread between the interest income on mortgage-backed securities and the costs of borrowing to finance the acquisition of these securities.

If at any time the character of our investments would cause us to be deemed an “investment company” for purposes of the Investment Company Act of 1940, we will take the necessary action to ensure that we are not deemed to be an “investment company.” Our Adviser will continually review our investment activity and the composition of our portfolio to ensure that we do not come within the application of the Investment Company Act.

Our working capital and other reserves will be invested in permitted temporary investments. Our Adviser will evaluate the relative risks and rates of return, our cash needs and other appropriate considerations when making short-term investments on our behalf. The rates of return of permitted temporary investments may be less than or greater than would be obtainable from real estate investments.

#### **Qualified REIT Subsidiaries**

While we intend to conduct substantially all of our activities through our Operating Partnership, we may also form one or more wholly-owned qualified REIT subsidiaries, or “QRSs,” to purchase properties. These QRSs would be formed for the sole purpose of acquiring a specific property or properties located in one or more states and would have organizational documents:

- that are substantially similar in all relevant ways to our organizational documents;
- that comply with all applicable state securities laws and regulations; and
- that comply with the applicable terms and conditions set forth in this prospectus.

#### **Joint Ventures**

We may enter into joint ventures, partnerships and other mutual arrangements with real estate developers, property owners and others for the purpose of obtaining an equity interest in a property in accordance with our investment policies. Many REITs have used joint ventures as sources of capital during periods where debt or equity capital was either unavailable or not available on favorable terms. Joint venture investments could permit us to own interests in large properties without unduly restricting the diversity of our portfolio. We will not enter into a joint venture to make an investment that we would not otherwise be permitted to make on our own. We expect that in any joint venture the cost of structuring joint investments would be shared ratably by us and the other participating investors.

#### **Use of Leverage**

##### ***Non-recourse financing***

Our strategy is to borrow, generally on a non-recourse basis, in amounts that we believe will maximize the return to our stockholders. We generally expect to enter into borrowing arrangements directly or indirectly through our Operating Partnership. The use of non-recourse financing allows us to limit our exposure on any property to the amount of equity invested in the property. Non-recourse financing generally restricts a lender’s claim on the assets of the borrower and, as a result, the lender generally may look only to the property securing the debt for satisfaction of the debt. We believe that this financing strategy will protect our other assets. However, there may be circumstances where lenders may have recourse to our other assets. There is no limitation on the amount we may borrow against any single investment property. Our board of directors has adopted a policy limiting our aggregate borrowings, as of

the time that the net proceeds of the offering have been fully invested and at the time of each subsequent borrowing, to two times our total equity. Our board of directors may change this policy at any time.

We believe that, by operating on a leveraged basis, we will have more funds available and, therefore, will make more investments than would otherwise be possible. We believe that this will result in a more diversified portfolio. Our Adviser will use its best efforts to obtain financing on the most favorable terms available to us.

We anticipate that prospective lenders may also seek to include in loans to us provisions whereby the termination or replacement of our Adviser would result in an event of default or an event requiring the immediate repayment of the full outstanding balance of the loan. We will generally seek to avoid the inclusion of these provisions and will attempt to negotiate loan terms that allow us to replace or terminate our Adviser if the action is approved by our board of directors. The replacement or termination of our Adviser may, however, require the prior consent of a lender.

We may refinance properties during the term of a loan when, in the opinion of our Adviser, a decline in interest rates makes it advisable to prepay an existing mortgage loan, when an existing mortgage loan matures or if an attractive investment becomes available and the proceeds from the refinancing can be used to purchase such investment. The benefits of the refinancing may include an increase in cash flow resulting from reduced debt service requirements, an increase in distributions to stockholders from proceeds of the refinancing, if any, or an increase in property ownership if some refinancing proceeds are reinvested in real estate.

### ***Securitization***

In the future we may use securitization as an additional method of borrowing. In a securitization, our Operating Partnership would issue one or more series of mortgage notes secured by real estate assets and related tenant leases or mortgage loans. We would deposit the collateralized mortgage notes to a single-purpose limited liability entity, which would issue one or more layers, or tranches, of investment certificates. We would seek to have some or all of the tranches of investment certificates rated by nationally recognized securities ratings agencies and would offer and sell the investment certificates, primarily to institutional investors. The funds received from the sale of investment certificates would be remitted back to our Operating Partnership to be used to acquire additional properties, make additional mortgage loans or to repay existing debt. This technique has been used by many REITs to gain substantial leverage at attractive rates. There can be no assurance that we will be able to utilize this financing technique in the future.

### **Other Investment Policies**

#### ***Working Capital Reserves***

We may establish a working capital reserve in an amount equal to one percent of the gross offering proceeds, which reserve we anticipate to be sufficient to satisfy our liquidity requirements. Our liquidity could be affected adversely by unanticipated costs, greater-than-anticipated operating expenses or cash shortfalls in funding our dividend at then-current rates. To the extent that the working capital reserve is insufficient to satisfy our cash requirements, additional funds may be produced from cash generated from operations or through short-term borrowings. In addition, subject to limitations described in this prospectus, we may incur indebtedness in connection with:

- the acquisition of any property;
- the refinancing of the debt upon any property; or
- the leveraging of any previously unleveraged property.

For additional information regarding our borrowing strategy, see “Investment Policies and Policies with Respect to Certain Activities — Additional Investment Considerations — Use of Leverage.”

### ***Holding Period For and Sale of Investments; Reinvestment of Sale Proceeds***

We intend to hold each property we acquire for an extended period. However, circumstances might arise which could result in the early sale of some properties. We may sell a property before the end of its expected holding period if in the judgment of our Adviser the sale of the property is in the best interest of our stockholders.

The determination of whether a particular property should be sold or otherwise disposed of will be made after consideration of all relevant factors, including prevailing economic conditions, with a view to achieving maximum capital appreciation. No assurance can be given that the foregoing objective will be realized. The selling price of a property which is subject to a net lease will be determined in large part by the amount of rent payable under the lease and the creditworthiness of the tenant. If a tenant has a repurchase option at a formula price, we may be limited in realizing any appreciation. In connection with our sales of properties we may lend the purchaser all or a portion of the purchase price. In these instances, our taxable income may exceed the cash received in the sale, which could cause us to delay required distributions to our stockholders. See “Federal Income Tax Consequences of our Status as a REIT — Distribution Requirements.”

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

We may continually reinvest the proceeds of property sales in investments that either we or our Adviser believe will satisfy our investment policies.

### ***Investment Limitations***

There are numerous limitations on the manner in which we may invest our funds. We have adopted a policy that we will not:

- invest in real property owned by our Adviser, any of its affiliates or any business in which our Adviser or any of its affiliates have invested;
- invest in commodities or commodity futures contracts, with this limitation not being applicable to futures contracts when used solely for the purpose of hedging in connection with our ordinary business of investing in properties and making mortgage loans;
- invest in contracts for the sale of real estate unless the contract is in recordable form and is appropriately recorded in the chain of title;
- engage in any short sale or borrowing that results in a debt to equity ratio greater than two-to-one;
- make investments in unimproved property or indebtedness secured by a deed of trust or mortgage loans on unimproved property in excess of 10% of our total assets. “Unimproved real property” means property which has the following three characteristics:
  - the property was not acquired for the purpose of producing rental or other operating income;
  - no development or construction is in process on the property; and
  - no development or construction on the property is planned in good faith to commence on the property within one year of acquisition;
- issue equity securities on a deferred payment basis or other similar arrangement except as set out in our equity incentive plans;
- issue debt securities in the absence of adequate cash flow to cover debt service;

- issue “redeemable securities” as defined in Section 2(a)(32) of the Investment Company Act of 1940;
- grant warrants or options to purchase shares of our stock to our Adviser or its affiliates, except pursuant to our equity incentive plans;
- engage in trading, as compared with investment activities, or engage in the business of underwriting, or the agency distribution of, securities issued by other persons;
- invest more than 5% of the value of our assets in the securities of any one issuer if the investment would cause us to fail to qualify as a REIT;
- invest in securities representing more than 10% of the outstanding securities (by vote or value) of any one issuer if the investment would cause us to fail to qualify as a REIT;
- acquire securities in any company holding investments or engaging in activities prohibited in the foregoing clauses; or
- make or invest in mortgage loans that are subordinate to any mortgage or equity interest of any of our affiliates.

#### **Conflict of Interest Policy**

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

We have adopted a policy that, without the approval of a majority of our disinterested directors, we will not:

- acquire from or sell to any of our officers, directors or employees, or any entity in which any of our officers, directors or employees has an interest of more than 5%, any assets or other property;
- borrow from any of our directors, officers or employees, or any entity in which any of our officers, directors or employees has an interest of more than 5%; or
- engage in any other transaction with any of our directors, officers or employees, or any entity in which any of our directors, officers or employees has an interest of more than 5%.

Consistent with the provisions of the Sarbanes-Oxley Act of 2002, we will not extend credit, or arrange for the extension of credit, to any of our directors and officers.

Under Maryland law, a contract or other transaction between us and one of our directors or any other entity in which one of our directors is also a director or has a material financial interest is not void or voidable solely on the grounds of the common directorship or interest, the fact that the director was present at the meeting at which the contract or transaction was approved or the fact that the director’s vote was counted in favor of the contract or transaction if:

- the fact of the common directorship or interest is disclosed to our board of directors or a committee of our board, and our board or the committee authorizes the contract or transaction by the affirmative vote of a majority of the directors not interested in the contract or transaction, even if the disinterested directors do not constitute a quorum of the board or committee;
- the fact of the common directorship or interest is disclosed to our stockholders entitled to vote on the contract or transaction, and the contract or transaction is approved by a majority of the votes cast by the stockholders entitled to vote on the matter, other than votes of shares owned of record or beneficially by the interested director, corporation, firm or other entity; or
- the contract or transaction is fair and reasonable to us.

Our policy also prohibits us from purchasing any property owned by or co-investing with our Adviser, any of its affiliates or any business in which our Adviser or any of its affiliates have invested. If we decide to change this policy on co-investments with our Adviser or its affiliates, we will seek approval of this decision from our stockholders.

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

Our independent directors will review our investment policies at least annually to determine that the policies we are following are in the best interest of our stockholders. The methods of implementing our investment policies also may vary as new investment techniques are developed. The methods of implementing our investment procedures, objectives and policies, except as otherwise provided in our bylaws or articles of incorporation, may be altered by a majority of our directors (including a majority of our independent directors) without the approval of our stockholders, to the extent that our board of directors determines that such modification is in the best interest of the stockholders. Among other factors, developments in the market which affect the policies and strategies mentioned in this prospectus or which change our assessment of the market may cause our board of directors to revise our investment policies and strategies.

#### **Legal Proceedings**

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

## MANAGEMENT

Our business and affairs are managed under the direction of our board of directors. Our board has retained our Adviser to manage our day-to-day operations and the acquisition and disposition of investments, subject to our board's oversight. We currently have two directors and prior to completion of this offering, we intend to expand the size of the board of directors to six.

Our board of directors elects our officers, who serve at the discretion of our board of directors. The address of each of our executive officers and directors is c/o Gladstone Commercial Corporation, 1750 Tysons Blvd., Fourth Floor, McLean, Virginia 22102.

### Our Directors and Executive Officers

Our directors and executive officers and their positions are as follows:

Name	Age	Office
David Gladstone	60	Chairman of our Board of Directors and Chief Executive Officer (4)
Terry Lee Brubaker	59	President, Secretary, Chief Operating Officer and Director
George Stelljes, III	41	Executive Vice President and Chief Investment Officer
Harry Brill	54	Chief Financial Officer and Treasurer
David A.R. Dullum	54	Director (1)(2)(3)(4)
Michela A. English	52	Director (1)(3)(5)
Anthony W. Parker	57	Director (1)(2)(3)(4)
Paul W. Adelgren	60	Director (1)(5)

(1) Messrs. Dullum, Parker and Adelgren and Ms. English have agreed to join our board of directors prior to the completion of this offering.

(2) Member of the compensation committee.

(3) Member of the audit committee.

(4) Member of the executive committee.

(5) Member of the ethics, nominating and corporate governance committee.

The following is a summary of certain biographical information concerning our directors and executive officers, many of whom also serve roles as directors and executive officers of our Adviser, and the principals of our Adviser:

*David Gladstone.* Mr. Gladstone is our founder and has served as our chief executive officer and chairman of our board of directors since our inception. Mr. Gladstone is also the founder of our Adviser and has served as chief executive officer and chairman of the board of directors of our Adviser since its inception. Mr. Gladstone also founded and serves as the chief executive officer and chairman of the board of directors of our affiliate Gladstone Capital Corporation (NASDAQ: GLAD). Prior to founding Gladstone Capital, Mr. Gladstone served as either chairman or vice chairman of the board of directors of American Capital Strategies (NASDAQ: ACAS), a publicly traded leveraged buyout fund and mezzanine debt finance company, from June 1997 to August 2001. From 1974 to February 1997, Mr. Gladstone held various positions, including chairman and chief executive officer, with Allied Capital Corporation (NYSE: ALD), Allied Capital Corporation II, Allied Capital Lending Corporation and Allied Capital Advisers, Inc., a registered investment adviser that managed the Allied companies. The Allied companies were the largest group of publicly-traded mezzanine debt funds in the United States and were managers of two private venture capital limited partnerships. From 1991 to 1997, Mr. Gladstone served as either chairman of the board of directors or president of Allied Capital Commercial Corporation, a publicly traded REIT that invested in real estate loans to small and medium-sized businesses, managed by Allied



Capital Advisers, Inc. He managed the growth of Allied Capital Commercial from no assets at the time of its initial public offering to \$385 million in assets at the time it merged into Allied Capital Corporation in 1997. From 1992 to 1997, Mr. Gladstone served as a director, president and chief executive officer of Business Mortgage Investors, a privately held mortgage REIT managed by Allied Capital Advisers, which invested in loans to small and medium-sized businesses. Mr. Gladstone is also a past director of Capital Automotive REIT, a real estate investment trust that purchases and net leases real estate to automobile dealerships. Mr. Gladstone served as a director of The Riggs National Corporation (the parent of Riggs Bank) from 1993 to May 1997 and of Riggs Bank from 1991 to 1993. He has served as a trustee of The George Washington University and currently is a trustee emeritus. He is a past member of the Listings and Hearings Committee of the National Association of Securities Dealers, Inc. He is a past member of the Advisory committee to the Women's Growth Capital Fund, a venture capital firm that finances women-owned small businesses. Mr. Gladstone was the founder and managing member of The Capital Investors, LLC, a group of angel investors, and is currently a member emeritus. He is also the chairman and owner of B & G Berry Corporation, a large strawberry farming operation in California and Gladstone Land Corporation, a privately held company that has substantial farmland holdings in agricultural real estate in California. Mr. Gladstone holds a MBA from the Harvard Business School, a MA from American University and a BA from the University of Virginia. Mr. Gladstone has co-authored two books on financing for small and medium-sized businesses, *Venture Capital Handbook* and *Venture Capital Investing*.

*Terry Lee Brubaker.* Mr. Brubaker has served as our president, secretary, chief operating officer and a director since our inception. Mr. Brubaker has also served as president and a director of our Adviser since its inception. Mr. Brubaker has also served as the president and chief operating officer and a director of Gladstone Capital since May 2001. In March 1999, Mr. Brubaker founded and, until May 1, 2003, served as chairman of Heads Up Systems, a company providing processing industries with leading edge technology. From 1996 to 1999, Mr. Brubaker served as vice president of the paper group for the American Forest & Paper Association. From 1992 to 1995, Mr. Brubaker served as president of Interstate Resources, a pulp and paper company. From 1991 to 1992, Mr. Brubaker served as president of IRI, a radiation measurement equipment manufacturer. From 1981 to 1991, Mr. Brubaker held several management positions at James River Corporation, a forest and paper company, including vice president of strategic planning from 1981 to 1982, group vice president of the Groveton Group and Premium Printing Papers from 1982 to 1990 and vice president of human resources development in 1991. From 1976 to 1981, Mr. Brubaker was strategic planning manager and marketing manager of white papers at Boise Cascade. Previously, Mr. Brubaker was a senior engagement manager at McKinsey & Company from 1972 to 1976. Prior to 1972, Mr. Brubaker was a U.S. Navy fighter pilot. Mr. Brubaker holds a MBA from the Harvard Business School and a BSE from Princeton University.

*George Stelljes, III.* Mr. Stelljes has served as our executive vice president and chief investment officer since our inception. Mr. Stelljes has also served as executive vice president of our Adviser since its inception and as a director of our Adviser since May 2003. In addition, Mr. Stelljes has served as executive vice president and chief investment officer of our affiliate Gladstone Capital since September 2002. He was a director of Gladstone Capital from August 2001 to September 2002. Prior to joining Gladstone Capital, Mr. Stelljes also served as a managing member of St. John's Capital, a vehicle used to make private equity investments. From 1999 to 2001, Mr. Stelljes was a co-founder and managing member of Camden Partners, a private equity firm which finances high growth companies in the communications, healthcare and business services sectors. From 1997 to 1999, Mr. Stelljes was a partner of Columbia Capital, a venture capital firm focused on investments in communications and information technology. Prior to joining Columbia, Mr. Stelljes was an executive vice president and a principal at Allied Capital Corporation from 1989 to 1997. Mr. Stelljes currently serves as a general partner and investment committee member of Patriot Capital, a private equity fund. He is also a former board member and regional president of the National Association of Small Business Investment Companies. Mr. Stelljes holds a MBA from the University of Virginia and a BA in Economics from Vanderbilt University.

*Harry Brill.* Mr. Brill has served as our treasurer and chief financial officer since our inception. Mr. Brill has also served as chief financial officer and a director of our Adviser since its inception. Since May 2001, Mr. Brill has also served as treasurer and chief financial officer of Gladstone Capital. From 1995 to April 2001, Mr. Brill served as a personal financial advisor. From 1975 to 1995, Mr. Brill held various positions, including treasurer, chief accounting officer and controller, with Allied Capital Corporation, where Mr. Brill was responsible for all of the accounting work for Allied Capital and its family of funds. Mr. Brill received his degree in accounting from Ben Franklin University.

*David A.R. Dullum.* Mr. Dullum has agreed to become a director prior to the completion of this offering. Mr. Dullum has served as a director of Gladstone Capital since August 2001. From 1995 to the present, Mr. Dullum has been a partner of New England Partners, a venture capital firm focused on investments in small and medium-sized businesses in the Mid-Atlantic and New England regions. From 1973 to 1990, Mr. Dullum was the managing general partner of Frontenac Company, a Chicago-based venture capital firm. Mr. Dullum holds a MBA from Stanford Graduate School of Business and a BME from the Georgia Institute of Technology.

*Michela A. English.* Ms. English has agreed to become a director prior to the completion of this offering. Ms. English has served as a director of Gladstone Capital since June 2002. Ms. English is the president of Discovery Consumer Products, a division of Discovery Communications, Inc., where she heads Discovery Channel's consumer and educational businesses. Since March 1996, Ms. English has held the positions of president of Discovery Enterprises Worldwide and president of Discovery.com. From 1991 to 1996, Ms. English served as senior vice president of the National Geographic Society and was a member of the National Geographic Society's Board of Trustees and Education Foundation Board. Prior to 1991, Ms. English served as vice president, corporate planning and business development for Marriott Corporation and as a senior engagement manager for McKinsey & Company. Ms. English currently serves as a director of the NEA Foundation for the Improvement of Education, the Educational Testing Service (ETS) and as chairman of the board of Sweet Briar College. Ms. English holds a Bachelor of Arts in International Affairs from Sweet Briar College and a Master of Public and Private Management degree from Yale University's School of Management.

*Anthony W. Parker.* Mr. Parker has agreed to become a director prior to the completion of this offering. Mr. Parker has served as a director of Gladstone Capital since August 2001. In 1997, Mr. Parker founded Medical Funding Corporation, a company which purchases medical receivables, and has served as its chairman from inception to the present. In the summer of 2000, Medical Funding Corporation purchased a Snelling Personnel Agency franchise in Washington, DC which provides full staffing services for the local business community. From 1992 to 1996, Mr. Parker was chairman of, and a 50% stockholder of, Capitol Resource Funding, Inc. ("CRF"), a commercial finance company with offices in Dana Point, California and Arlington, Virginia. Mr. Parker joined CRF shortly after its inception and was instrumental in growing the company from a startup to one that by 1996 was purchasing receivables at the rate of \$150 million per year, with over 40 employees. Mr. Parker practiced corporate and tax law for over 15 years – from 1980 to 1983 at Verner, Liipfert, Bernhard & McPherson, and from 1983 to 1992 in private practice. From 1973 to 1977 Mr. Parker served as executive assistant to the administrator of the US Small Business Administration. Mr. Parker received his J.D. and Masters in Tax Law from Georgetown Law Center and his undergraduate degree from Harvard College.

*Paul W. Adelgren.* Mr. Adelgren has agreed to become a director prior to the completion of this offering. Mr. Adelgren has served as a director of Gladstone Capital since January 2003. From 1997 to the present, Mr. Adelgren has served as the pastor of Missionary Alliance Church. From 1991 to 1997, Mr. Adelgren was pastor of New Life Alliance Church. From 1988 to 1991, Mr. Adelgren was a vice president of the finance and materials division of Williams & Watts, Inc., a logistics management and procurement business located in Fairfield, NJ. Prior to joining Williams & Watts, Mr. Adelgren served in the United States Navy, where he served in a number of capacities, including as the director of the Strategic Submarine Support Department, as an executive officer at the Naval Supply Center and as the director of the Joint Uniform Military Pay System. Mr. Adelgren holds a MBA from Harvard University and a BA from the University of Kansas.

## Principals of our Adviser

The following is a summary of certain biographical information regarding the principals of our Adviser. Biographical information concerning our Adviser's executive officers and directors is described above.

*Arthur "Buzz" Cooper.* Mr. Cooper has been a principal of our Adviser since its inception and has also been a principal of Gladstone Capital since June 2001. From 1986 to 2000, Mr. Cooper served as a principal of Allied Capital Corporation. At Allied Capital, Mr. Cooper was responsible for identifying, sourcing, underwriting, managing, financing and servicing all forms of commercial real estate. During his time at Allied Capital, Mr. Cooper also administered an investment portfolio of over \$250 million. Mr. Cooper holds a BA from Washington and Lee University.

*Virginia Rollins.* Ms. Rollins has been a principal of our Adviser since its inception and has also been a principal of Gladstone Capital since June 2001. From 1998 to May 2001, Ms. Rollins served as vice president and principal of American Capital Strategies, where she was responsible for marketing, originations, underwriting and portfolio management for the Bethesda, Maryland office. From 1993 to 1997, Ms. Rollins served as managing director and deputy managing director of Bulgarian American Enterprise Fund, a private investment firm which focuses on making loans to and investments in Bulgaria. Ms. Rollins holds a Masters of International Management from the American Graduate School of International Management and a BA from the University of North Carolina, Chapel Hill.

*Joseph Bute.* Mr. Bute has been a principal of our Adviser since its inception and has also been a principal of Gladstone Capital since June 2001. From 1996 to April 2001, Mr. Bute served as principal and vice president of American Capital Strategies, where he was responsible for marketing, originations, underwriting and portfolio management for the Pittsburgh, Pennsylvania office. During that period, he invested \$35 million for American Capital in four companies and served as a director of each. From 1992 to 1996, Mr. Bute was director of manufacturing services of the Steel Valley Authority where he established and developed a nationally recognized manufacturing retention program for the Commonwealth of Pennsylvania. Mr. Bute holds a BS from the University of San Francisco.

*Laura Gladstone.* Ms. Gladstone has been a principal of our Adviser since its inception and has also been a principal of Gladstone Capital since August 2001. From June 2000 to April 2001, Ms. Gladstone worked as an associate in equity research at ING Barings, where she was responsible for covering companies in the telecommunications industries. From November 1999 to May 2000, Ms. Gladstone worked for Salomon Smith Barney as an assistant analyst in equity research. From 1997 to November 1999, Ms. Gladstone worked for HSBC, an international bank, as the bank's only syndications analyst in Argentina. At HSBC, she completed numerous loan transactions in diverse industries, including cable, telecommunications, oil, manufacturing and distribution. From 1994 to 1997, Ms. Gladstone served as the marketing director at Allied Capital Corporation where she was responsible for creating and executing all marketing-related activities for leveraged buyout and venture capital investments, mortgage REIT loans and small business lending activities. She received her BBA from The George Washington University. Ms. Gladstone is the co-author of *Venture Capital Handbook* and *Venture Capital Investing*. Ms. Gladstone is the daughter of David Gladstone.

*John Freal.* Mr. Freal has been a principal of our Adviser since its inception and has also been a principal of Gladstone Capital since February 2002. From November 1997 through February 2002, he was a principal and managing director at American Capital Strategies in the Bethesda, Maryland office, where he was responsible for investment originations, underwriting and portfolio management. From May 1995 through October 1997, he was a private investor and financial consultant. From June 1989 to April 1995, Mr. Freal was president of RDS Capital Partners, Inc. of Vienna, Virginia, a private merchant banking company that he co-founded to acquire middle-market commercial and industrial companies. Prior to founding RDS, he was employed from November 1978 to June 1989 by First American Bank of Virginia, Maryland National Bank and Meritor Financial Group, providing general corporate and buyout financing to middle-market and national companies in various capacities from credit analyst to vice president and loan officer. Mr. Freal received his BBA and MBA from George Mason University.

We expect our Adviser to hire two more principals and two associates during 2003, all of whom we expect will have real estate experience. We also expect our Adviser to hire a controller that will be responsible for providing accounting services to us.

## **Our Board of Directors**

### ***Composition of our Board of Directors***

Effective upon the closing of this offering, our directors will be divided into three classes. One class will hold office initially for a term expiring at the annual meeting of our stockholders to be held in 2004, a second class will hold office initially for a term expiring at the annual meeting of our stockholders to be held in 2005 and a third class will hold office initially for a term expiring at the annual meeting of our stockholders to be held in 2006. Each director holds office for the term to which he or she is elected until his or her successor is duly elected and qualified. The terms of Mr. Gladstone and Mr. Adelgren will expire in 2004, the terms of Mr. Parker and Ms. English will expire in 2005 and the terms of Mr. Brubaker and Mr. Dullum will expire in 2006. At each annual meeting of our stockholders, the class of directors whose terms expire at such meeting will be elected to hold office for a three year term. Although the number of directors may be increased or decreased, a decrease shall not have the effect of shortening the term of any incumbent director.

A majority of our board of directors must be comprised of independent directors as defined by the listing standards of the Nasdaq Stock Market. Following the completion of this offering, two of our directors will be insiders and four will be independent.

Our directors are not required to devote all of their time to our business and are only required to devote as much time to our affairs as their duties require. Our directors will generally meet quarterly or more frequently if necessary.

### ***Vacancies on our Board of Directors***

Any director may resign at any time and may be removed with cause by the stockholders upon the affirmative vote of at least two-thirds of all the votes entitled to be cast at a meeting called for the purpose of the proposed removal. The notice of the meeting shall indicate that the purpose, or one of the purposes, of the meeting is to determine if the director shall be removed. The term "cause" as used in this context is a term used in the Maryland General Corporation Law. However, the Maryland General Corporation Law does not include a definition of "cause," and Maryland case law suggests that the term should be interpreted on a case-by-case basis. As a result of this uncertainty, stockholders may not know what actions by a director may be grounds for removal.

Unless filled by a vote of the stockholders as permitted by Maryland law, a vacancy created by an increase in the number of directors or the death, resignation, removal, adjudicated incompetence or other incapacity of a director shall be filled by a vote of a majority of the remaining directors.

### ***Limited Liability and Indemnification***

We maintain a directors and officers liability insurance policy. Our articles of incorporation limit the personal liability of our directors and officers for monetary damages to the fullest extent permitted under current Maryland law, and our bylaws provide that a director or officer may be indemnified to the fullest extent required or permitted by Maryland law. Maryland law allows directors and officers to be indemnified against judgments, penalties, fines, settlements, and expenses actually incurred in a proceeding unless the following can be established:

- the act or omission of the director or officer was material to the cause of action adjudicated in the proceeding, and was committed in bad faith or was the result of active and deliberate dishonesty;
- the director or officer actually received an improper personal benefit in money, property or services; or

- with respect to any criminal proceeding, the director or officer had reasonable cause to believe his or her act or omission was unlawful.

Any indemnification or any agreement to hold harmless is recoverable only out of our assets and not from our stockholders. Indemnification could reduce the legal remedies available to us and our stockholders against the indemnified individuals.

This provision for indemnification of our directors and officers does not reduce the exposure of our directors and officers to liability under federal or state securities laws, nor does it limit a stockholder's ability to obtain injunctive relief or other equitable remedies for a violation of a director's or an officer's duties to us or to our stockholders, although the equitable remedies may not be effective in some circumstances.

In addition to any indemnification to which our directors and officers are entitled pursuant to our articles of incorporation and bylaws and the Maryland General Corporation Law, our articles of incorporation and bylaws provide that we may indemnify other employees and agents to the fullest extent permitted under Maryland law, whether they are serving us or, at our request, any other entity, including our Adviser.

The general effect to investors of any arrangement under which any person who controls us or any of our directors, officers or agents is insured or indemnified against liability is a potential reduction in distributions to our stockholders resulting from our payment of premiums associated with liability insurance. In addition, indemnification could reduce the legal remedies available to us and to our stockholders against our officers, directors and agents.

The SEC takes the position that indemnification against liabilities arising under the Securities Act of 1933 is against public policy and unenforceable. As a result, indemnification of our directors and officers and of our Adviser or its affiliates may not be allowed for liabilities arising from or out of a violation of state or federal securities laws. Indemnification will be allowed for settlements and related expenses of lawsuits alleging securities laws violations and for expenses incurred in successfully defending any lawsuit, provided that a court either

- approves the settlement and finds that indemnification of the settlement and related costs should be made; or
- dismisses with prejudice or makes a successful adjudication on the merits of each count involving alleged securities law violations as to the particular indemnitee and a court approves the indemnification.

#### **Committees of our Board of Directors**

##### *Executive Committee*

Our board of directors has established an executive committee. Membership of our executive committee will be comprised of Messrs. Gladstone (Chairman), Dullum and Parker. The executive committee has the authority to exercise all powers of our board of directors except for actions that must be taken by the full board of directors under the Maryland General Corporation Law.

##### *Audit Committee*

Our board of directors has established an audit committee. Membership of the audit committee will be comprised of Mr. Parker (Chairman), Ms. English and Mr. Dullum, each of whom is an independent director. The audit committee will be responsible for, among other things, the engagement of and approving the compensation of independent public accountants, reviewing with our independent public accountants the plans and results of the audit engagement, approving professional services provided by our independent public accountants, reviewing the independence of our independent public accountants, reviewing our quarterly financial statements and earnings releases and reviewing the adequacy of our internal accounting controls.

### ***Compensation Committee***

Our board of directors has established a compensation committee. Membership of the compensation committee will be comprised of Messrs. Dullum (Chairman) and Parker, each of whom is an independent director. The compensation committee will be responsible for, among other things, determining compensation for our executive officers and negotiating the terms of our advisory agreement, in addition to administering our 2003 Equity Incentive Plan, which is described below.

### ***Ethics, Nominating and Corporate Governance Committee***

Our board of directors has established an ethics, nominating and corporate governance committee. Membership of the committee will be comprised of Mr. Adelgren (Chairman) and Ms. English, each of whom is an independent director. The ethics, nominating and corporate governance committee will be responsible for, among other things, establishing and maintaining our code of ethics, approving the nomination of qualified individuals to become directors, recommending the composition of committees of our board of directors, monitoring a process to assess our board's effectiveness, and developing and implementing our corporate governance guidelines and policies.

### **Compensation of our Directors and Executive Officers**

#### ***Compensation of Directors***

As compensation for serving on our board of directors, each of our independent directors will receive an annual fee of \$10,000 and an additional \$1,000 for each board meeting attended, with no additional fee paid in connection with attending committee meetings. In addition, we will reimburse our directors for their reasonable out-of-pocket expenses incurred in attending board and committees meetings. Upon joining our board, each independent director will receive a non-qualified option to purchase 10,000 shares of our common stock having an exercise price equal to the price of our common stock in this offering or the quoted price of our common stock on the Nasdaq National Market on the date of grant, as applicable. At the time of each annual meeting of our stockholders following his or her appointment, each incumbent independent director will receive an additional non-qualified option to purchase 10,000 shares of our common stock with an exercise price equal to the fair market value of the common stock on the date of grant. All options granted to independent directors will vest in two equal annual installments beginning one year from the date of grant.

We will not pay any compensation to our directors who also serve as our officers or as officers or directors of our Adviser in consideration for their service as our directors. Our board of directors may change the compensation of our independent directors in its discretion. None of our independent directors is expected to receive compensation during the fiscal year ended December 31, 2003 other than for board meeting attendance.

#### ***Executive Compensation***

Because our executive officers are employees of our Adviser, we do not pay cash compensation to them directly in return for their services to us. Rather, they receive compensation from our Adviser pursuant to the terms of their employment relationships with our Adviser. However, our executive officers are eligible to participate in our 2003 Equity Incentive Plan, described below. The following table summarizes the option grants that we expect to make to each of our executive officers prior to the completion of this offering (the exercise price of each of the options is expected to be \$15 per share):

- David Gladstone:            shares
  
- Terry Lee Brubaker:        shares
  
- George Stelljes, III:        shares
  
- Harry Brill:                shares

It is expected that these options will vest in two equal installments on the date of grant and the first anniversary of the date of grant.

## **2003 Equity Incentive Plan**

Effective June 10, 2003, we adopted the 2003 Equity Incentive Plan, which we refer to as the 2003 Plan in this prospectus, for the purpose of attracting and retaining the services of executive officers, directors and other key employees. Under the 2003 Plan, our compensation committee may award to employees incentive stock options within the meaning of Section 422 of the Internal Revenue Code, or ISOs, and nonstatutory stock options to employees, non-employee directors and certain consultants, including our Adviser and its affiliates. In addition, the 2003 Plan permits the granting of restricted stock.

We have authorized the issuance of 625,000 shares of common stock to our officers, directors, employees and consultants, including the employees and directors of our Adviser under the 2003 Plan. Options granted under the 2003 Plan may be exercised for a period of no more than ten years from the date of grant or, in the case of ISOs granted to any recipient who owns, or is treated as owning, under Section 424(d) of the Internal Revenue Code, more than 10% of the total combined voting power of our stock, no more than five years from the date of grant. No awards may be granted under the 2003 Plan to any person who, assuming exercise or settlement of all options and rights held by such person, would own or be deemed to own more than 9.8% of the outstanding shares of our capital stock without approval of our board of directors. Unless sooner terminated by our board of directors, the 2003 Plan will terminate on June 9, 2013, and no additional awards may be made under the 2003 Plan after that date.

### ***Stock Options***

Options granted under the 2003 Plan will entitle the optionee, upon exercise, to purchase shares of common stock from us at a specified exercise price per share. ISOs must have a per share exercise price of no less than the fair market value of a share of our common stock on the date of the grant or, if the optionee owns or is treated as owning, under Section 424(d) of the Internal Revenue Code, more than 10% of the total combined voting power of all classes of our stock, no less than 110% of the fair market value of a share of our common stock on the date of the grant. Nonstatutory stock options granted under the 2003 Plan must have a per share exercise price of no less than 85% of the fair market value of a share of our common stock on the date of the grant. Options will not be transferable other than by laws of descent, distribution and, in the case of nonstatutory stock options, assignment or grant to a trust, individual retirement account or pension plan that is for the benefit of the optionee.

Our compensation committee will administer the 2003 Plan and will have the authority, subject to the provisions of the 2003 Plan, to determine who will receive awards under the 2003 Plan and the terms of such awards. Our compensation committee will have the authority to adjust the number of shares available for options, the number of shares subject to outstanding options and the exercise price for options following the occurrence of events such as stock splits, dividends, distributions and recapitalizations.

If authorized by our compensation committee, the exercise price of an option may be paid in the form of shares of our common stock that are already owned by a participant. In addition, our compensation committee may permit, when appropriate, a "cashless exercise" arrangement whereby an optionee may exercise a portion of his or her option by surrendering a portion of the shares subject to his or her option having a fair value equal to the aggregate exercise price of the portion of the option being exercised. If an optionee elects to make a cashless exercise of a portion of his or her option, he or she will receive upon such exercise shares having an aggregate fair market value equal to the product of (1) the excess of the fair market value of a share of our common stock on the exercise date over the exercise price and (2) the number of shares covered by the portion of the option being exercised.

The 2003 Plan provides that if a stock option is not exercised and the option expires for any reason, then the shares of common stock subject to the option will be available for reissuance under the 2003 Plan.

### ***Restricted Stock***

Participants in the 2003 Plan are eligible to receive grants of restricted stock. These shares may be subject to a time-based vesting schedule or the attainment of performance goals established by our compensation committee. Restricted stock may be sold or may be issued for no cash consideration as determined by our compensation committee. Upon a participant's termination of service with us, we may have the option to repurchase or reclaim the unvested shares of stock at the original purchase price paid by a participant for such shares, if any. The specific terms and conditions of the restricted stock purchases shall be governed by the 2003 Plan and individual agreements in a form approved by our compensation committee. Restricted stock acquired under the 2003 Plan is transferable if so determined by our compensation committee in its discretion.

### ***Corporate Transactions and Change in Control Provisions***

Upon specified corporate transactions, as defined in the 2003 Plan, all outstanding stock options and restricted stock under the 2003 Plan may either be assumed or new awards may be substituted by the successor or surviving entity. If the surviving entity does not assume or substitute similar awards, the vesting of awards held by the participants whose continuous service has not terminated prior to the closing date of the corporate transaction will be accelerated in full and then terminated to the extent not exercised, if appropriate, prior to the closing date of the corporate transaction. With respect to any other awards which are not assumed or substituted and which are held by participants whose continuous service has terminated on or prior to the closing date of the corporate transaction, such awards will not be accelerated unless otherwise provided in a written agreement between us and the participant and approved by the compensation committee.

Upon a corporate transaction that constitutes a change in control, as defined in the 2003 Plan, awards of stock options and restricted stock held by participants whose continuous service has not terminated prior to the date of the change in control will be entitled to additional acceleration of vesting, but only to the extent as provided in any written agreement between us and the participant and approved by the compensation committee.

### ***Federal Tax Consequences***

The following is a brief summary of the federal income tax aspects of awards under the 2003 Plan of compensatory stock options and restricted stock to employees and other service providers in exchange for services based upon the federal income tax laws in effect on the date of this prospectus. This summary is not intended to be exhaustive and does not describe state or local tax consequences.

- *Incentive stock options.* No taxable income is realized by the participant upon the grant or exercise of an ISO. If shares of stock are issued to a participant pursuant to the exercise of an ISO, and if no disposition of the shares is made by the participant within two years of the date of grant or within one year after the transfer of the shares to the participant (a "disqualifying disposition"), then: (i) upon the sale of the shares, any amount realized in excess of the exercise price will be taxed to the participant as a long-term capital gain, and any loss sustained will be a capital loss, and (ii) no deduction will be allowed to us for federal income tax purposes. The exercise of an ISO will give rise to an item of tax preference that may result in an alternative minimum tax liability for the participant unless the participant makes a disqualifying disposition of the shares received upon exercise.

If stock acquired upon the exercise of an ISO is disposed of prior to the expiration of the holding periods described above in a disqualifying disposition, then generally: (i) the participant will realize ordinary income in the year of disposition in an amount equal to the excess, if any, of the fair market value of the shares at exercise (or, if less, the amount realized on the disposition of the shares) over the exercise price paid for such shares, and (2) we will be entitled to deduct any such recognized amount. Any further gain or loss realized by the participant will be taxed as short-term or long-term capital gain or loss, as the case may be, and will not result in any deduction by us.



Subject to certain exceptions for disability or death, if an ISO is exercised more than three months following the termination of the participant's employment, the option will generally be taxed as a nonstatutory stock option.

- *Nonstatutory stock options.* With respect to nonstatutory stock options: (1) no income is realized by the participant at the time the option is granted; (2) generally upon exercise of the option, the participant realizes ordinary income in an amount equal to the difference between the exercise price paid for the shares and the fair market value of the shares on the date of exercise and we will be entitled to a deduction in the same amount; and (3) at disposition, any appreciation (or depreciation) after the date of exercise is treated either as short-term or long-term capital gain or loss, depending upon the length of time that the participant has held the shares.
- *Restricted Stock Awards.* To the extent a participant's restricted stock award is fully vested and is not subject to our repurchase option, the participant will recognize taxable ordinary income equal to any excess of the stock's fair market value on the purchase date over the purchase price. In contrast, to the extent a restricted stock award is subject to a vesting schedule, taxable income with respect to stock will be recognized at each vesting date in an amount equal to the excess of the fair market value of the shares vesting on such date over the consideration paid for those shares. However, a participant may file with the Internal Revenue Service an election under Section 83(b) of the Internal Revenue Code, by which the participant elects to recognize at the time of grant ordinary income equal to the excess, if any, of the then fair market value of the stock received on the date of grant over the participant's purchase price, if any. Generally, we will be entitled to a tax deduction equal to the ordinary income recognized by the participant.

## CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

### Advisory Agreement

We have entered into an advisory agreement with our Adviser, Gladstone Management Corporation, pursuant to which our Adviser will be responsible for managing our business on a day-to-day basis and for identifying, evaluating, negotiating and consummating investment transactions consistent with our investment criteria. In return for providing such services, we have agreed to reimburse our Adviser for certain expenses it incurs related to its management of our activities on the following bases:

- reimbursement on a dollar-for-dollar basis for all expenses incurred by our Adviser for our direct benefit (for example, organizational and offering expenses, legal, accounting, tax and consulting fees), which we currently estimate will be approximately \$1.3 million during the first twelve months following the completion of this offering (including approximately \$1 million of expenses incurred in connection with this offering) and \$300,000 annually thereafter;
- reimbursement on a dollar-for-dollar basis for all additional fees charged by third parties that are directly related to our business (for example, real estate brokerage fees, mortgage placement fees, lease-up fees and transaction structuring fees), which we currently are unable to estimate; and
- reimbursement of our Adviser for our pro rata portion of our Adviser's total operating expenses, such as payroll and other overhead expenses, attributable to our business, based on the percentage of total hours worked by our Adviser's personnel that are spent on our matters (such reimbursement for operating expenses shall not be greater than 2.5% of our average invested assets on an annual basis), which we currently estimate will be approximately \$700,000 during the first twelve months following the completion of this offering.

The estimated reimbursements set forth above are based on our current expectations regarding the expenses of this offering, operating expenses of our Adviser and the proportion of our Adviser's time we believe will be spent on matters relating to our business. To the extent that the expenses of this offering are greater than we anticipate, or if our Adviser's operating expenses increase or our Adviser allocates a greater percentage of its time to our business, our actual reimbursements to the Adviser could be materially greater than currently projected.

Each of our officers is an officer of our Adviser and Messrs. Gladstone, Brubaker and Brill are also directors of our Adviser. David Gladstone is the controlling stockholder of our Adviser. The advisory agreement was not negotiated at arm's-length, although we believe that its terms are no less favorable to us than those that we could obtain from an unaffiliated third party in an arm's-length transaction.

### OUR ADVISER

#### Gladstone Management Corporation

Our business will be managed by our Adviser, Gladstone Management Corporation. The officers, directors and employees of our Adviser have significant experience in making investments in and lending to small and medium-sized businesses, including investing in real estate and making mortgage loans. We have entered into an advisory agreement with our Adviser under which our Adviser will be responsible for managing our assets and liabilities, for operating our business on a day-to-day basis and for identifying, evaluating, negotiating and consummating investment transactions consistent with our investment policies as determined by our board of directors from time to time.

David Gladstone, our chairman and chief executive officer, is also the chairman, chief executive officer and the controlling stockholder of our Adviser. Terry Lee Brubaker, our president, secretary and chief operating officer and a member of our board of directors, serves in the same capacities for our Adviser. George Stelljes, III, our chief investment officer, serves in the same capacity for our Adviser and

is also a member of our Adviser's board of directors. Harry Brill, our chief financial officer and treasurer, serves in the same capacities for our Adviser and is also a member of our Adviser's board of directors.

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

Our Adviser's board of directors has empowered its investment committee to authorize and approve our investments, subject to the terms of the advisory agreement. Before we acquire any property, the transaction will be reviewed by our Adviser's investment committee to ensure that, in its view, the proposed transaction satisfies our investment criteria and is within our investment policies. Approval by our Adviser's investment committee will generally be the final step in the property acquisition approval process, although the separate approval of our board of directors will be required in certain circumstances described below.

Our Adviser's executive offices are located at 1750 Tysons Blvd., Fourth Floor, McLean, Virginia 22102.

### **Advisory Agreement**

Many of the services to be performed by our Adviser and its affiliates in managing our day-to-day activities are summarized below. This summary is provided to illustrate the material functions which our Adviser and its affiliates will perform for us pursuant to the terms of the advisory agreement, but it is not intended to include all of the services which may be provided to us by third parties.

#### ***Adviser Duties and Authority Under the Advisory Agreement***

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

- find, evaluate, present and recommend to us a continuing series of real estate investment opportunities consistent with our investment policies and objectives;
- provide advice to us and act on our behalf with respect to the negotiation, acquisition, financing, refinancing, holding, leasing and disposition of real estate investments;
- enter contracts to purchase real estate and make loans on our behalf in compliance with our investment procedures, objectives and policies, subject to approval of our board of directors, where required;
- take the actions and obtain the services necessary to effect the negotiation, acquisition, financing, refinancing, holding, leasing and disposition of real estate investments; and
- provide day-to-day management of our business activities and other administrative services for us as requested by our board of directors.

It is expected that each investment that we make will be approved or ratified by our board of directors. Our board of directors has authorized our Adviser to make investments in any property on our behalf without the prior approval of our board if the following conditions are satisfied:

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

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

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

- loans not secured or otherwise supported by real property;
- any acquisition or mortgage loan which at the time of investment would have a cost exceeding 20% of our total assets;
- any lease or mortgage loan to a tenant or borrower having a risk rating of less than 4 on our risk rating scale;
- transactions that involve conflicts of interest with our Adviser (other than reimbursement of expenses in accordance with the advisory agreement); and
- the lease of assets to our Adviser, its affiliates or any of our officers or directors.

In addition to its duties under the advisory agreement, our Adviser and its affiliates expect to engage in other business ventures and, as a result, their resources will not be dedicated exclusively to our business. For example, our Adviser also serves as external adviser to Gladstone Land Corporation, an affiliate of our chairman and chief executive officer David Gladstone. However, under the advisory agreement, our Adviser must devote sufficient resources to the administration of our affairs to discharge its obligations under the agreement. The advisory agreement is not assignable or transferable by either us or our Adviser without the consent of the other party, except that our Adviser may assign the advisory agreement to an affiliate for whom our Adviser agrees to guarantee its obligations to us. Either we or our Adviser may assign or transfer the advisory agreement to a successor entity. Our Adviser's professionals have operated under similar arrangements during their service with Allied Capital Advisers, which advised the Allied Capital group of three public investment companies, two private limited partnerships, one public REIT and one private REIT.

#### ***Termination of the Advisory Agreement***

The term of the advisory agreement ends on December 31, 2006, and thereafter will be automatically renewed for successive one-year periods, unless either we or our Adviser gives the other party notice of non-renewal at least 120 days before the end of any term. Additionally, the advisory agreement may be terminated:

- immediately by us for "cause" or upon the bankruptcy of our Adviser;
- without cause by a majority of our independent directors upon 60 days' notice to our Adviser; or
- immediately with "good reason" by our Adviser.

"Cause" is defined in the advisory agreement to mean fraud, criminal conduct, willful misconduct or willful or negligent breach of fiduciary duty, or the commission of a material breach of the advisory agreement, by our Adviser. "Good reason" is defined in the advisory agreement to mean either a failure to obtain a satisfactory agreement from any successor to us to assume and agree to perform our obligations under the advisory agreement, or a material breach of the advisory agreement of any nature whatsoever by us.

#### ***Payments to our Adviser Under the Advisory Agreement***

The following sets forth the type and, to the extent possible, estimates of the amounts payable to our Adviser in connection with its operation of our business. These payments have not been determined

through non-arm's-length bargaining. For additional details regarding the effects of this non-arm's-length relationship, see "Conflicts of Interest."

We will reimburse our Adviser for all expenses incurred by our Adviser for our direct benefit. Examples of these expenses include expenses incurred in connection with our organization and offering, legal, accounting, tax preparation, consulting and related fees. The actual amounts to be paid will depend upon the actual amount of organization and offering expenses paid and incurred by our Adviser and its affiliates in connection with this offering, which amount is not determinable at this time. We currently estimate these expenses will be approximately \$1.3 million (including approximately \$1 million of expenses incurred in connection with this offering) during the first twelve months. We estimate that these expenses will be approximately \$300,000 per year after the first twelve months following the offering.

In addition, we will reimburse our Adviser 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 that will be passed through to us at the cost to our Adviser. The actual amount that we will pay to our Adviser will depend largely upon the aggregate costs of the properties we acquire and loans that we make, which in turn will depend upon the proceeds of this offering and the amount of leverage we use in connection with our activities. Accordingly, the amount of these fees is not determinable at this time.

We will also reimburse our Adviser for our pro rata portion of our Adviser's total operating expenses not reimbursed under the arrangements described above, such as payroll and other overhead expenses, equal to the total operating expenses of our Adviser, multiplied by the ratio of hours worked by our Adviser's employees on our projects to the total hours worked by our Adviser's employees, subject to a maximum of 2.5% of our average invested assets for the year. Our Adviser will bill us on a monthly basis for these amounts. Our Adviser must reimburse us at least annually for the amount by which amounts billed to and paid by us exceed this 2.5% limit during a given year. To the extent that operating expenses payable or reimbursable by us exceed this limit and our independent directors determine that the excess expenses were justified based on unusual and nonrecurring factors which they deem sufficient, we may reimburse our Adviser in future years for the full amount of the excess expenses, or any portion thereof, but only to the extent that the reimbursement would not cause our operating expenses to exceed the 2.5% limitation in any year.

The actual amount of operating expenses for which we will be required to reimburse our Adviser is not determinable, but we currently estimate that during our first full year following the completion of this offering this amount will be approximately \$700,000. This estimate is based on our current expectations regarding our Adviser's operating 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 operating 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 operating expenses could be materially greater than we currently project.

In addition to the reimbursement of expenses described above, our Adviser's officers, directors and employees will be eligible to receive stock option grants from the 2003 Plan. See "Management — 2003 Equity Incentive Plan."

Our board of directors is responsible for reviewing our fees and expenses on at least an annual basis and with sufficient frequency to determine that the expenses incurred are in the best interests of our stockholders. Our independent directors also will be responsible for reviewing the performance of our Adviser and determining whether the compensation paid to our Adviser is reasonable in relation to the nature and quality of services performed and whether the provisions of the advisory agreement are being satisfactorily performed. Specifically, our independent directors will consider factors such as:

- the amount of the fees paid to our Adviser in relation to our size and the composition and performance of our investments;
- the success of our Adviser in generating appropriate investment opportunities;

- rates charged to other investment entities by advisers performing similar services;
- additional revenues realized by our Adviser and its affiliates through their relationship with us, whether paid by us or by others with whom we do business;
- the value of our assets each quarter;
- the quality and extent of service and advice furnished by our Adviser and the performance of our investment portfolio; and
- the quality of our portfolio relative to the investments generated by our Adviser for its other clients.

#### ***Other Transactions with our Adviser and its Affiliates***

From time to time we may enter into transactions with our Adviser or one or more of its affiliates. A majority of our independent directors and a majority of our directors not otherwise interested in a transaction with our Adviser must approve all such transactions with our Adviser or its affiliates. See “Conflicts of Interest.”

We will not purchase any property from or co-invest with our Adviser, any of its affiliates or any business in which our Adviser or any of its affiliates have invested. If we decide to change this policy on co-investments with our Adviser or its affiliates, we will seek approval of this decision from our stockholders.

#### **CONFLICTS OF INTEREST**

There will be various conflicts of interest in the operation of our business. Our independent directors will have an obligation to function on our behalf in all situations in which a conflict of interest may arise and will have a fiduciary obligation to act on behalf of our stockholders.

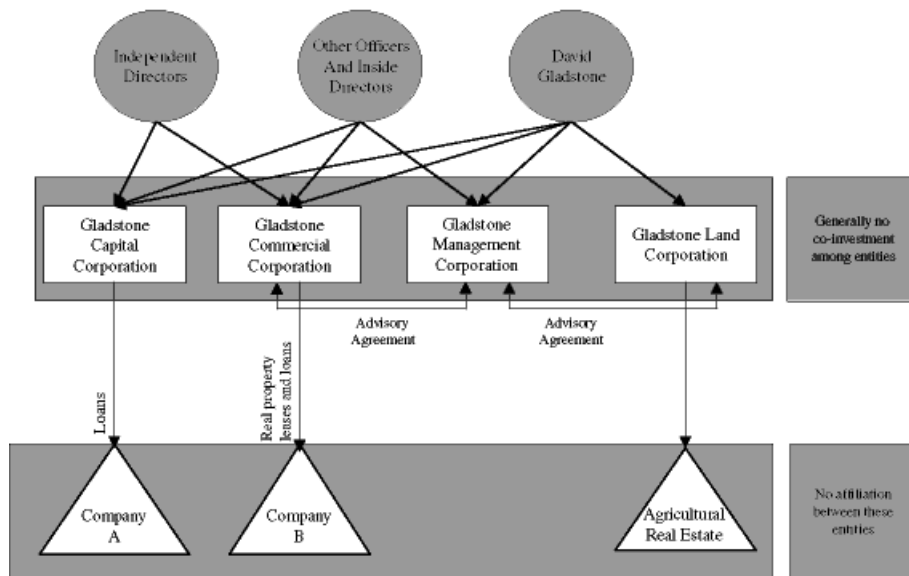
#### **Our Affiliates**

All of our directors and officers are also affiliated with Gladstone Capital Corporation, as a result of which we may be deemed to be an affiliate of Gladstone Capital. Gladstone Capital is a publicly held closed-end management investment company that makes loans to and investments in small and medium-sized businesses. It does not buy or lease real estate. Gladstone Capital will not make loans to or investments in any company with which we have or intend to enter into a lease or loan. David Gladstone, our chairman and chief executive officer, also serves as chairman of Gladstone Land Corporation, a privately held corporation which invests primarily in agricultural real estate.

We do not presently intend to co-invest with Gladstone Capital, Gladstone Land or any other affiliated entity in any business. However, in the future it may be advisable for us to co-invest with one of our affiliates. If we decide to change our policy on co-investments with affiliates, we will seek approval of this decision from our stockholders. Any such co-investment must be approved by a majority of our independent directors and must not jeopardize our status as a REIT. Additionally, Gladstone Capital may also need to receive an order from the Securities and Exchange Commission under the Investment Company Act of 1940 permitting these arrangements.

Our Adviser is an external management company that does not buy or lease real estate, other than for its own use, in the ordinary course of its business. We will not co-invest with our Adviser nor will our Adviser make loans to or investments in any company with which we have entered into a lease or loan arrangement. The following chart illustrates generally the relationship among us, our Adviser and our affiliates.

**Gladstone Commercial Corporation and Its Affiliates**



Every transaction we enter into with our Adviser or its affiliates is subject to an inherent conflict of interest. Our board of directors may encounter conflicts of interest in enforcing our rights against any of our affiliates in the event of a default by or disagreement with an affiliate or in invoking powers, rights or options pursuant to any agreement between us and any of our affiliates. Each transaction between us and our Adviser or any of its affiliates must be approved by a majority of our independent directors who are otherwise disinterested in the transaction as being fair and reasonable to us and on terms and conditions no less favorable to us than those available from unaffiliated third parties.

**Experience of Our Adviser’s Professionals in Managing Conflicts of Interest**

Many of the officers and directors of our Adviser have operated under a similar structure in connection with their service to Allied Capital Advisers, which managed three publicly traded investment companies, one publicly traded REIT, one privately held REIT and two private partnerships and we believe that their experience will allow them to successfully manage potential conflicts of interest inherent in our business.

**Potential Conflicts of Interest Inherent in Our Business**

***Our Adviser may realize substantial compensation.***

Our Adviser will receive reimbursement from us regardless of our performance or its performance in managing our business. As a result, even if our Adviser does not identify suitable opportunities in which to invest the proceeds of this offering, our Adviser will still be reimbursed for the expenses that it incurs in connection with attempting to invest such funds on our behalf. In addition, our Adviser will also receive reimbursement of expenses and fees incurred directly on our behalf regardless of its or our performance. See “Our Adviser – Advisory Agreement – Payments to our Adviser Under the Advisory Agreement.”

***Our agreements with our Adviser are not arm's-length agreements.***

All agreements and arrangements, including those relating to payments under the advisory agreement, between us and our Adviser or any of its affiliates will not be the result of arm's-length negotiations. However, compensation to our Adviser and its affiliates will be approved by a majority of our independent directors and terms of future transactions with our Adviser shall be no less favorable to us than terms that we believe we could obtain from unaffiliated entities providing similar services as an ongoing activity in the same geographical location.

***We may experience competition with our affiliates for financing transactions.***

Gladstone Capital specializes in providing long-term loans to small and medium-sized businesses. Gladstone Capital does not, and for regulatory reasons cannot, purchase or sell real estate or interests in real estate or real estate investment trusts (subject to limited exceptions). However, Gladstone Capital may make loans to, or investments in, companies as a means of providing financing for their acquisition of real estate. While such a transaction would typically not fit within the current investment criteria of Gladstone Capital, particularly if the sole purpose of the loan were to finance the purchase of real estate, there may be circumstances in which Gladstone Capital would make such a loan. Therefore, Gladstone Capital may compete with us with respect to making loans to finance the purchase of real property.

Our Adviser will use its best efforts to present suitable investments to us consistent with our investment procedures, objectives and policies. If our Adviser or any of its affiliates is presented with a potential investment in a property which might be made by more than one investment entity which it advises or manages, the decision as to the suitability of the property for investment by a particular entity will be based upon a review of the investment portfolio and objectives of each entity. The most important criteria in allocating investment opportunities between Gladstone Capital, Gladstone Land, any other entities our Adviser manages and us will be whether the potential investment is a commercial or industrial real estate-related opportunity, in which case it would generally be presented to us. Other factors which our Adviser will consider include:

- cash flow from the property;
- the effect of the acquisition of the property on the diversification of each entity's portfolio;
- rental payments during any renewal period;
- the amount of equity required to make the investment;
- the policies of each entity relating to leverage;
- the funds of each entity available for investment; and
- the length of time the funds have been available for investment and the manner in which the potential investment can be structured by each entity.

Consideration will be given by our Adviser to joint ownership (e.g., tenancy-in-common or joint venture arrangements) of a particular property determined to be suitable for more than one investment entity in order to achieve diversification of each entity's portfolio and efficient completion of an entity's portfolio. In joint ownership, we expect that the investment of each entity will be on substantially similar terms and conditions, compensation to the organizer of each investment entity will be similar and each investment entity will have a right of first refusal to purchase the interest of the other if a sale of that interest is contemplated. For additional information regarding the risks associated with joint ventures, see "Risk Factors — Our potential participation in joint ventures creates additional risk." To the extent that a particular property might be determined to be suitable for more than one investment entity, priority generally will be given to the investment entity having uninvested funds for the longest period of time. It is the responsibility of our board of directors (including our independent directors) to ensure that the method used by our Adviser to allocate transactions is applied fairly to us.



*Our Adviser or its affiliates could acquire properties adjacent to properties held by us.*

Although we do not expect it to occur, if our Adviser or any of its affiliates acquires properties that are adjacent to one of our properties, the value of such properties may be enhanced by our interests. It also is possible that these properties could be in competition with our properties for prospective tenants.

*Our Adviser or its affiliates could compete for the time and services of our officers and directors.*

We depend on our board of directors and on our Adviser for our operations and for the acquisition, operation and disposition of our investments. Our Adviser has entered into the advisory agreement with us pursuant to which it will perform certain functions relating to the investment of our funds and our day-to-day management. Our Adviser may perform similar services for other entities managed by our Adviser or its affiliates. Our Adviser and its affiliates will devote such time to our affairs as they in good faith determine to be necessary. Neither our Adviser nor any of their respective affiliates are restricted from acting as general partner or as an adviser to REITs, real estate partnerships or other entities which may have objectives similar to ours and which are sponsored by affiliated or non-affiliated persons.

#### PRINCIPAL STOCKHOLDERS

Immediately prior to the completion of this offering, there will be 52,000 shares of common stock outstanding and one stockholder of record. We will have no other shares of capital stock outstanding. We do not anticipate that, upon completion of this offering, any of our current stockholders will beneficially own more than five percent of our common stock. The following table sets forth certain ownership information with respect to our common stock for each of our directors and executive officers and for all directors and executive officers as a group, upon completion of this offering. Unless otherwise indicated, all shares are owned directly and the indicated person has sole voting and investment power. The information in the table below does not include any shares that the named individuals may purchase in this offering.

Name of Beneficial Owner	Number of Shares Beneficially Owned	Percent of Class (1)
David Gladstone	52,000	1.1%
Terry Lee Brubaker	0	*
George Stelljes, III	0	*
Harry Brill (2)	0	*
David A.R. Dullum (2)	0	*
Michela A. English (2)	0	*
Anthony W. Parker (2)	0	*
Paul W. Adलगren (2)	0	*
All executive officers and directors as a group (eight persons)	52,000	1.1%

\* Represents less than 1% of the number of shares of common stock outstanding upon completion of the offering.

- (1) Does not reflect shares of common stock reserved for issuance upon exercise of the underwriters' over-allotment option.
- (2) Messrs. Dullum, Parker and Adलगren and Ms. English have agreed to join our board of directors prior to the completion of this offering.

## DESCRIPTION OF OUR CAPITAL STOCK

### General

Our authorized capital stock consists of 20,000,000 shares of capital stock, \$0.001 par value per share, all of which is initially designated as common stock. Under our articles of incorporation, our board of directors is authorized to classify and reclassify any unissued shares of capital stock by setting or changing in any one or more respects, from time to time before issuance of such stock, the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications and terms and conditions of redemption of such stock. Upon completion of this offering (assuming no exercise of the underwriters' over-allotment option), 4,472,000 shares of common stock will be issued and outstanding and no shares of preferred stock will be issued and outstanding. The following summary description of our capital stock is not necessarily complete and is qualified in its entirety by reference to our articles of incorporation.

### Voting Rights of Common Stock

Subject to the provisions of our articles of incorporation regarding restrictions on the transfer and ownership of our capital stock, each outstanding share of common stock entitles the holder to one vote on all matters submitted to a vote of stockholders, including the election of directors, and, except as provided with respect to any other class or series of capital stock (of which there currently is none), the holders of the common stock possess the exclusive voting power. There is no cumulative voting in the election of directors, which means that the holders of a majority of the outstanding common stock, voting as a single class, can elect all of the directors then standing for election and the holders of the remaining shares are not able to elect any directors.

### Dividends, Liquidations and Other Rights

All shares of common stock offered by this prospectus will be duly authorized, fully paid and nonassessable. Holders of our common stock are entitled to receive dividends when declared by our board of directors out of assets legally available for the payment of dividends. They also are entitled to share ratably in our assets legally available for distribution to our stockholders in the event of our liquidation, dissolution or winding up, after payment of or adequate provision for all of our known debts and liabilities. These rights are subject to the preferential rights of any other class or series of our shares (of which there currently is none) and to the provisions of our articles of incorporation regarding restrictions on transfer of our shares.

Holders of our common stock have no preference, conversion, exchange, sinking fund, redemption or appraisal rights and have no preemptive rights to subscribe for any of our securities. Subject to the restrictions on transfer of shares contained in our articles of incorporation, all shares of common stock have equal dividend, liquidation and other rights.

### Certificates

We will not issue certificates. Shares will be held in "uncertificated" form which will eliminate the physical handling and safekeeping responsibilities inherent in owning transferable stock certificates and eliminate the need to return a duly executed stock certificate to the transfer agent to effect a transfer. Transfers can be effected simply by mailing to us a duly executed transfer form. Upon the issuance of our shares, we will send to each stockholder a written statement which will include all information that is required to be written upon stock certificates under Maryland law.

### Meetings and Special Voting Requirements

An annual meeting of the stockholders will be held each May for the purpose of electing the class of directors whose term is up for election and to conduct other business that may be before the stockholders. Special meetings of stockholders may be called only upon the request of a majority of our directors, a

majority of our independent directors, our chairman, our president or upon the written request of stockholders entitled to cast at least 20% of all the votes entitled to be cast at a meeting. In general, the presence in person or by proxy of a majority of the outstanding shares, exclusive of excess shares (described in “Certain Provisions of Maryland Law and of Our Articles of Incorporation and Bylaws — Restrictions on Ownership of Shares” below), shall constitute a quorum. Generally, the affirmative vote of a majority of the votes entitled to be voted at a meeting at which a quorum is present is necessary to take stockholder action, except that a plurality of all votes cast at such a meeting is sufficient to elect a director.

A proposal by our board of directors to amend our articles of incorporation or to dissolve us requires the approval at a duly held meeting of our stockholders holding at least a majority of the shares entitled to vote. Stockholders may, by the affirmative vote of two-thirds of the shares entitled to vote on such matter, elect to remove a director for cause. Stockholders do not have the ability to vote to replace our Adviser or to select a new adviser.

The affirmative vote of a majority of all shares entitled to vote is required to approve any merger or sale of substantially all of our assets other than in the ordinary course of business. The term “substantially all” as used in this context is a term used in the Maryland General Corporate Law. The Maryland General Corporation Law does not include a definition of “substantially all” and Maryland case law suggests that the term be interpreted on a case-by-case basis. The effect for investors of the Maryland law’s lack of definition is that we cannot provide investors with a definition for “substantially all” and therefore stockholders will not know whether a sale of assets will constitute a sale of substantially all of the assets and, therefore, whether they will have the right to approve any particular sale.

### **Information Rights**

Any stockholder may, during normal business hours and for any lawful and proper purpose, inspect and copy our bylaws, minutes of the proceedings of our stockholders, our annual financial statements and any voting trust agreement that is on file at our principal office. In addition, one or more stockholders who together are, and for at least six months have been, record or beneficial holders of 5% of our common stock are entitled to inspect a copy of our stockholder list upon written request. The list will include the name and address of, and the number of shares owned by, each stockholder and will be available at our principal office within 20 days of the stockholder’s request.

The rights of stockholders described above are in addition to, and do not adversely affect rights provided to investors under, Rule 14a-7 promulgated under the Securities Exchange Act of 1934, which provides that, upon request of investors and the payment of the expenses of the distribution, we are required to distribute specific materials to stockholders in the context of the solicitation of proxies for voting on matters presented to stockholders, or, at our option, provide requesting stockholders with a copy of the list of stockholders so that the requesting stockholders may make the distribution themselves.

### **Distributions**

Distributions will be paid to investors who are stockholders as of the record date selected by our board of directors. Distributions will be paid on a quarterly basis regardless of the frequency with which such distributions are declared. We are required to make distributions sufficient to satisfy the REIT requirements. Generally, income distributed as distributions will not be taxable to us under federal income tax laws unless we fail to comply with the REIT requirements.

Distributions will be paid at the discretion of our board of directors based on our earnings, cash flow and general financial condition. The directors’ discretion will be governed, in substantial part, by their obligation to cause us to comply with the REIT requirements. Because we may receive income from interest or rents at various times during our fiscal year, distributions may not reflect our income earned in that particular distribution period but may be made in anticipation of cash flow which we expect to receive during a later quarter and may be made in advance of actual receipt in an attempt to make distributions relatively uniform. We may borrow to make distributions if the borrowing is necessary to maintain our

REIT status, or if the borrowing is part of a liquidation strategy whereby the borrowing is done in anticipation of the sale of properties and the proceeds will be used to repay the loan.

We are not prohibited from distributing securities in lieu of making cash distributions to stockholders, provided that the securities distributed to stockholders are readily marketable. Stockholders who receive marketable securities in lieu of cash distributions may incur transaction expenses in liquidating the securities. For additional information with respect to distributions, see the “Dividend Policy” section of this prospectus.

#### **Repurchases of Excess Shares**

We have the authority to redeem “excess shares” (as defined in our articles of incorporation) immediately upon becoming aware of the existence of excess shares or after giving the holder of the excess shares 30 days to transfer the excess shares to a person whose ownership of such shares would not exceed the ownership limit and, therefore such shares would no longer be considered excess shares. The price paid upon redemption by us shall be the lesser of the price paid for such excess shares by the stockholder holding the excess shares or the fair market value of the excess shares. We may purchase excess shares or otherwise repurchase shares if the repurchase does not impair our capital or operations. For additional information regarding excess shares, see “Certain Provisions of Maryland Law and of our Articles of Incorporation and Bylaws — Restrictions on Ownership of Shares.”

**CERTAIN PROVISIONS OF MARYLAND LAW AND  
OF OUR ARTICLES OF INCORPORATION AND BYLAWS**

*The following description of certain provisions of Maryland law and of our articles of incorporation and bylaws is only a summary. For a complete description, we refer you to the Maryland General Corporation Law, our articles of incorporation and our bylaws. We have filed our articles of incorporation and bylaws as exhibits to the registration statement of which this prospectus is a part.*

**Classification of our Board of Directors**

Pursuant to our bylaws, upon completion of this offering, our board of directors will be divided into three classes of directors. Directors of each class are elected for a three-year term, and each year one class of directors will be elected by the stockholders. The initial terms of the Class I, Class II and Class III directors will expire in 2004, 2005 and 2006, respectively, and when their respective successors are duly elected and qualify. Any director elected to fill a vacancy shall serve for the remainder of the full term of the class in which the vacancy occurred and until a successor is elected and qualifies. We believe that classification of our board of directors helps to assure the continuity and stability of our business strategies and policies as determined by our directors. Holders of shares of our common stock have no right to cumulative voting in the election of directors. Consequently, at each annual meeting of stockholders, the holders of a majority of the common stock are able to elect all of the successors of the class of directors whose terms expire at that meeting.

Our classified board could have the effect of making the replacement of incumbent directors more time consuming and difficult. At least two annual meetings of stockholders, instead of one, will generally be required to effect a change in a majority of our board of directors. Thus, our classified board could increase the likelihood that incumbent directors will retain their positions. The staggered terms of directors may delay, defer or prevent a tender offer or an attempt to change control of us or another transaction that might involve a premium price for our common stock that might be in the best interest of our stockholders.

**Removal of Directors**

Any director may be removed only for cause by the stockholders upon the affirmative vote of at least two-thirds of all the votes entitled to be cast at a meeting called for the purpose of the proposed removal. The notice of the meeting shall indicate that the purpose, or one of the purposes, of the meeting is to determine if the director shall be removed.

**Restrictions on Ownership of Shares**

In order for us to qualify as a REIT, not more than 50% of our outstanding shares may be owned by any five or fewer individuals (including some tax-exempt entities) during the last half of each taxable year, and the outstanding shares must be owned by 100 or more persons independent of us and each other during at least 335 days of a 12-month taxable year or during a proportionate part of a shorter taxable year for which an election to be treated as a REIT is made. We may prohibit certain acquisitions and transfers of shares so as to facilitate our continued qualification as a REIT under the Internal Revenue Code. However, there can be no assurance that this prohibition will be effective.

Our articles of incorporation, in order to assist our board of directors in preserving our status as a REIT, contain an ownership limit which prohibits any person or group of persons from acquiring, directly or indirectly, beneficial ownership of more than 9.8% of our outstanding shares of capital stock. Shares owned by a person or a group of persons in excess of the ownership limit are deemed "excess shares." Shares owned by a person who individually owns of record less than 9.8% of outstanding shares may nevertheless be excess shares if the person is deemed part of a group for purposes of this restriction.

Our articles of incorporation stipulate that any purported issuance or transfer of shares shall be valid only with respect to those shares that do not result in the transferee-stockholder owning shares in excess of

the ownership limit. If the transferee-stockholder acquires excess shares, the person is considered to have acted as our agent and holds the excess shares on behalf of the ultimate stockholder.

The ownership limit does not apply to offerors which, in accordance with applicable federal and state securities laws, make a cash tender offer, where at least 90% of the outstanding shares of our common stock (not including shares or subsequently issued securities convertible into common stock which are held by the tender offeror and any "affiliates" or "associates" thereof within the meaning of the Securities Exchange Act of 1934) are duly tendered and accepted pursuant to the cash tender offer. The ownership limit also does not apply to the underwriter in a public offering of our shares. The ownership limit also does not apply to a person or persons which our directors so exempt from the ownership limit upon appropriate assurances that our qualification as a REIT is not jeopardized.

### **Business Combinations**

Maryland law prohibits "business combinations" between us and an interested stockholder or an affiliate of an interested stockholder for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include a merger, consolidation, share exchange, or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities. Maryland law defines an interested stockholder as:

- any person who beneficially owns 10% or more of the voting power of our shares; or
- an affiliate or associate of ours who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10% or more of the voting power of our then-outstanding voting shares.

A person is not an interested stockholder if our board of directors approved in advance the transaction by which the person otherwise would have become an interested stockholder. However, in approving a transaction, our board of directors may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by our board of directors.

After the five-year prohibition, any business combination between us and an interested stockholder generally must be recommended by our board of directors and approved by the affirmative vote of at least:

- 80% of the votes entitled to be cast by holders of our then-outstanding shares of capital stock; and
- two-thirds of the votes entitled to be cast by holders of our voting shares other than shares held by (a) the interested stockholder with whom or with whose affiliate the business combination is to be effected and (b) shares held by an affiliate or associate of the interested stockholder.

These super-majority vote requirements do not apply if our common stockholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares. The statute permits various exemptions from its provisions, including business combinations that are exempted by our board of directors before the time that the interested stockholder becomes an interested stockholder. The business combination statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

### **Merger; Amendment of Articles of Incorporation**

Under Maryland law, we will not be able to amend our articles of incorporation or merge with another entity unless approved by the affirmative vote of stockholders holding at least a majority of the shares entitled to vote on the matter. As permitted by Maryland law, our articles of incorporation contain a provision permitting our directors, without any action by our stockholders, to amend the articles of incorporation to increase or decrease the aggregate number of shares of stock or the number of shares of any class of stock that we have authority to issue.

## **Operations**

We generally are prohibited from engaging in certain activities, including acquiring or holding property or engaging in any activity that would cause us to fail to qualify as a REIT.

## **Term and Termination**

Our articles of incorporation provide for us to have a perpetual existence. Pursuant to our articles of incorporation, and subject to the provisions of any of our classes or series of stock then outstanding and the approval by a majority of the entire board of directors, our stockholders, at any meeting thereof, by the affirmative vote of a majority of all of the votes entitled to be cast on the matter, may approve a plan of liquidation and dissolution.

## **Advance Notice of Director Nominations and New Business**

Our bylaws provide that, with respect to an annual meeting of stockholders, nominations of persons for election to our board of directors and the proposal of business to be considered by stockholders at the annual meeting may be made only:

- pursuant to our notice of the meeting;
- by our board of directors; or
- by a stockholder who was a stockholder of record both at the time of the provision of notice and at the time of the meeting who is entitled to vote at the meeting and has complied with the advance notice procedures set forth in our bylaws.

With respect to special meetings of stockholders, only the business specified in our notice of meeting may be brought before the meeting of stockholders and nominations of persons for election to our board of directors may be made only:

- pursuant to our notice of the meeting;
- by our board of directors; or
- provided that our board of directors has determined that directors shall be elected at such meeting, by a stockholder who was a stockholder of record both at the time of the provision of notice and at the time of the meeting who is entitled to vote at the meeting and has complied with the advance notice provisions set forth in our bylaws.

## **Power to Issue Additional Shares**

We currently do not intend to issue any securities other than the shares described in this prospectus and the shares issuable under the 2003 Plan, although we may do so at any time, including upon the redemption of limited partnership interests that we may issue in connection with acquisitions of real property. We believe that the power to issue additional shares of stock and to classify or reclassify unissued shares of common stock or preferred stock and thereafter to issue the classified or reclassified shares provides us with increased flexibility in structuring possible future financings and acquisitions and in meeting other needs which might arise. These actions can be taken without stockholder approval, unless stockholder approval is required by applicable law or the rules of any stock exchange or automated quotation system on which our securities may be listed or traded. Although we have no present intention of doing so, we could issue a class or series of shares that could delay, defer or prevent a transaction or a change in control that might involve a premium price for holders of common stock or otherwise be in their best interest.

## **Control Share Acquisitions**

Maryland law provides that “control shares” of a corporation acquired in a “control share acquisition” have no voting rights unless the corporation’s stockholders approve such voting rights by a vote of two-

thirds of the votes entitled to be cast on the matter. Shares owned by the acquiror, or by officers or directors of the corporation who are also employees are excluded from shares entitled to vote on the matter. "Control shares" are voting shares which, if aggregated with all other shares previously acquired by the acquiring person, or in respect of which the acquiring person is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiring person to exercise voting power in electing directors within one of the following ranges of voting power:

- one-tenth or more but less than one-third of all voting power;
- one-third or more but less than a majority of all voting power; or
- a majority or more of all voting power.

Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained stockholder approval. A "control share acquisition" means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition may compel our board of directors to call a special meeting of stockholders to be held within 50 days to consider the voting rights of the shares. The right to compel the calling of a special meeting is subject to the satisfaction of certain conditions, including providing a statement to us detailing, among other things, the acquiring person's identity and stock ownership and an undertaking to pay the expenses of the meeting. If no request for a meeting is made, we may present the question at any stockholders' meeting.

If voting rights are not approved at the stockholders' meeting or if the acquiring person does not deliver the statement required by Maryland law, then, subject to certain conditions and limitations, we may redeem any or all of the control shares, except those for which voting rights have previously been approved, at the fair market value of such shares. The control share acquisition statute does not apply to shares acquired in a merger, consolidation or share exchange if we are a party to the transaction, nor does it apply to acquisitions approved or exempted by our articles of incorporation or bylaws.

#### **Possible Anti-Takeover Effect of Certain Provisions of Maryland Law and of Our Articles of Incorporation and Bylaws**

The business combination provisions and the control share acquisition provisions of Maryland law, the provisions of our bylaws regarding the classification of our board of directors and the restrictions on the transfer of stock and the advance notice provisions of our bylaws could have the effect of delaying, deferring or preventing a transaction or a change in the control that might involve a premium price for holders of common stock or otherwise be in their best interest.

#### **SHARES ELIGIBLE FOR FUTURE SALE**

Upon completion of this offering, 4,472,000 shares of our common stock will be outstanding, based on the number of shares outstanding on June 10, 2003 and assuming no exercise of the underwriters' over-allotment option and without giving effect to the potential exercise of any options by our officers and directors. Of these shares, the 4,420,000 shares of our common stock sold in this offering will be freely tradable without restriction or limitation under the Securities Act, with the exception of any shares purchased in the directed share offering and any additional shares purchased by our affiliates. Shares of our common stock purchased in the directed share offering will be restricted from resale for a period of 180 days following the completion of this offering. In addition, any shares of common stock purchased by our affiliates in this offering will be subject to the manner of sale and volume limitations of Rule 144 promulgated under the Securities Act. In addition, the remaining 52,000 shares of common stock held by David Gladstone, our chairman and chief executive officer, prior to this offering, will be subject to a lockup agreement in favor of the underwriters which generally provides that he shall not sell, offer to sell, contract to sell, hypothecate, grant any option to sell or otherwise dispose of, directly or indirectly, any shares of our common stock or securities convertible into or exchangeable for shares of our common stock.



or warrants or other rights to purchase shares of our common stock for a period of 180 days after the date of this prospectus. The representatives of the underwriters may, in their sole discretion and at any time without notice, release all or any portion of the securities subject to the lockup agreements. Such shares owned by Mr. Gladstone will become eligible for public resale under Rule 144 on February 15, 2004.

#### **DIVIDEND REINVESTMENT PLAN**

Pursuant to our dividend reinvestment plan, if your shares of our common stock are registered in your own name you can have all distributions reinvested in additional shares of our common stock by The Bank of New York, the plan agent, if you enroll in the reinvestment plan by delivering an authorization form to the plan agent prior to the corresponding dividend declaration date. The plan agent will effect purchases of our common stock under the reinvestment plan in the open market. If you do not elect to participate in the reinvestment plan, you will receive all distributions in cash paid by check mailed directly to you (or if you hold your shares in street or other nominee name, then to your nominee) as of the relevant record date, by the plan agent, as our dividend disbursing agent. If your shares are held in the name of a broker or nominee or if you are transferring such an account to a new broker or nominee, you should contact the broker or nominee to determine whether and how they may participate in the reinvestment plan.

The plan agent serves as agent for the holders of our common stock in administering the reinvestment plan. After we declare a dividend, the plan agent will, as agent for the participants, receive the cash payment and use it to buy shares of our common stock on the Nasdaq National Market or elsewhere for the participants' accounts. The price of the shares will be the average market price at which such shares were purchased by the plan agent.

Participants in the reinvestment plan may withdraw from the reinvestment plan upon written notice to the plan agent. Such withdrawal will be effective immediately if received not less than ten days prior to a dividend record date; otherwise, it will be effective the day after the related dividend distribution date. When a participant withdraws from the reinvestment plan or upon termination of the reinvestment plan as provided below, certificates for whole shares of common stock credited to his or her account under the reinvestment plan will be issued and a cash payment will be made for any fractional share of common stock credited to such account.

The plan agent will maintain each participant's account in the reinvestment plan and will furnish quarterly written confirmations of all transactions in such account, including information needed by the stockholder for personal and tax records. Common stock in the account of each reinvestment plan participant will be held by the plan agent in non-certificated form in the name of such participant. Proxy materials relating to our stockholders' meetings will include those shares purchased as well as shares held pursuant to the reinvestment plan.

In the case of participants who beneficially own shares that are held in the name of banks, brokers or other nominees, the plan agent will administer the reinvestment plan on the basis of the number of shares of common stock certified from time to time by the record holders as the amount held for the account of such beneficial owners. Shares of our common stock may be purchased by the plan agent through any of the underwriters, acting as broker or, after the completion of this offering, as a dealer.

We will pay the plan agent's fees for the handling or reinvestment of dividends and other distributions. Each participant in the reinvestment plan will pay a pro rata share of brokerage commissions incurred with respect to the plan agent's open market purchases in connection with the reinvestment of distributions. There are no other charges to participants for reinvesting distributions.

Distributions are taxable whether paid in cash or reinvested in additional shares, and the reinvestment of distributions pursuant to the reinvestment plan will not relieve participants of any federal or state income tax that may be payable or required to be withheld on such distributions.

Experience under the reinvestment plan may indicate that changes are desirable. Accordingly, we reserve the right to amend or terminate the reinvestment plan as applied to any distribution paid

subsequent to written notice of the change sent to participants in the reinvestment plan at least 90 days before the record date for the distribution. The reinvestment plan also may be amended or terminated by the plan agent with our prior written consent, on at least 90 days' written notice to participants in the reinvestment plan. All correspondence concerning the reinvestment plan should be directed to the plan agent by mail at 100 Church Street, 14th Floor, New York, New York 10286 or by phone at (800) 274-2944. The Bank of New York also maintains an Internet web site at <http://stock.bankofny.com>.

## OUR OPERATING PARTNERSHIP

### Overview

We will conduct substantially all of our activities through, and substantially all of our properties will be held directly or indirectly by, our Operating Partnership. We will control our Operating Partnership as its sole general partner and will also initially 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 real property or mortgage loans. 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 after the first anniversary of the completion of this offering.

Our board of directors and our Adviser will manage the affairs of our Operating Partnership by directing its affairs as general partner of our Operating Partnership. In turn, our Operating Partnership will pay the advisory fees of our Adviser. Whenever we issue common stock for cash, we will be obligated to contribute any net proceeds we receive therefrom to our Operating Partnership, and our Operating Partnership will be obligated to issue an equivalent number of units to us. Our limited and general partnership interests in our Operating Partnership will entitle us to share in cash distributions from, and in the profits and losses of, our Operating Partnership in proportion to our percentage interests therein and will entitle us to vote on all matters requiring a vote of the limited partners.

Generally, pursuant to the terms of the limited partnership agreement of our Operating Partnership and provisions of Delaware law, we, as the sole general partner, will have the exclusive power to manage and conduct the business of our Operating Partnership and will otherwise have the rights and powers permitted to the general partner of a Delaware limited partnership. In addition to the rights specifically described in this prospectus, the holders of units in our Operating Partnership will have such rights and powers as are reserved to limited partners under Delaware law, but generally will have no authority to transact business for or participate in the management activities or decisions of our Operating Partnership. The limited partners do not have the right to remove us as general partner.

Limited partners of our Operating Partnership may only transfer units with our consent and in compliance with applicable regulations and other restrictions set forth in the limited partnership agreement. A transferee of units will be admitted to our Operating Partnership as a substitute limited partner only with our consent. The limited partnership agreement permits us to cause our Operating Partnership to issue additional units without the consent of the limited partners.

### Comparison of Common Stock and Units

Conducting our operations through our Operating Partnership will allow those who sell property to us to defer certain tax consequences by contributing their economic interest to our Operating Partnership in exchange for limited partnership units, rather than contributing their interest to us in exchange for cash or shares of our common stock. Upon completion of this offering, we will hold units of interest in our Operating Partnership. Each unit is designed to result in a distribution per unit equal to a distribution per share of our common stock. After one year following completion of this offering, the holders of units may redeem each unit for an amount of cash equal to the then-quoted market price of our common stock or, at our option, one share of our common stock (subject to certain antidilution adjustments and certain limitations on exchange to preserve our status as a REIT). The following is a comparison of the ownership

of our common stock and units of our Operating Partnership with respect to voting rights and transferability:

- *Voting Rights.* Holders of common stock may elect our board of directors, and because we serve as the general partner of our Operating Partnership, our board of directors will effectively control the business of our Operating Partnership. Unit holders may not elect or remove the general partner without our consent or, prior to redemption of units in exchange for our common stock, elect our directors.
- *Transferability.* Neither the units of our Operating Partnership nor the shares of our common stock issuable upon redemption of such units will have been registered under the Securities Act and, therefore, they will be subject to certain restrictions on transfer. The units and the shares of our common stock for which they are redeemable are subject to transfer restrictions under applicable securities laws, under our articles of incorporation or under the limited partnership agreement, including the required consent of the general partner to the admission of any new limited partner to our Operating Partnership. We may from time to time grant registration rights with respect to shares of our common stock issuable upon redemption of units.

## **Partnership Agreement**

The following summary of the limited partnership agreement of our Operating Partnership and the description of certain provisions thereof set forth elsewhere in this prospectus are qualified in their entirety by reference to the limited partnership agreement.

### ***Management***

Under the terms of the partnership agreement, as the sole general partner of our Operating Partnership, we have, subject to certain protective rights of limited partners described below, full, exclusive and complete responsibility and discretion in the management, operation and control of the partnership, including the ability to cause the partnership to enter into certain major transactions including acquisitions, dispositions, refinancings and selection of tenants and to cause changes in the partnership's line of business and distribution policies. We are in turn managed by our Adviser, which will have responsibility for all aspects of our operations, including the management of our Operating Partnership.

The affirmative vote of the general partner and at least a majority of the partnership units is required for a sale of all or substantially all of the assets of the partnership, to approve a merger or consolidation of the partnership or to amend the partnership agreement. Upon completion of this offering and the formation transactions, we will own a 100% interest in the partnership.

### ***Transferability of Interests***

We may not voluntarily withdraw from our Operating Partnership or transfer or assign our interest in our Operating Partnership unless the transaction in which such withdrawal or transfer occurs results in the limited partners receiving property in an amount equal to the amount they would have received had they exercised their redemption rights immediately prior to such transaction, or unless our successor contributes substantially all of its assets to our Operating Partnership in return for a general partnership interest in our Operating Partnership. With certain limited exceptions, the limited partners may not transfer their interests in our Operating Partnership, in whole or in part, without our written consent, which consent we may withhold in our sole discretion. We may not consent to any transfer that would cause our Operating Partnership to be treated as a corporation for federal income tax purposes.

### ***Capital Contributions and Additional Units***

We will contribute to our Operating Partnership substantially all of the net proceeds of this offering as our initial capital contribution in exchange for a 100% partnership interest. The partnership agreement permits us, without the consent of the limited partners, to cause the issuance of additional partnership

units in return for future capital contributions by third parties. The partnership agreement provides that if our Operating Partnership requires additional funds at any time in excess of funds available to our Operating Partnership from borrowing or capital contributions, we may borrow such funds from a financial institution or other lender and lend such funds to our Operating Partnership on the same terms and conditions as are applicable to our borrowing of such funds. Under the partnership agreement, we are obligated to contribute the proceeds of any offering of shares of capital stock as additional capital to our Operating Partnership. If we contribute additional capital to our Operating Partnership, we will receive additional partnership units and our percentage interest will be increased on a proportionate basis based upon the amount of such additional capital contributions and the value of our Operating Partnership at the time of such contributions. Conversely, the percentage interests of the limited partners will be decreased on a proportionate basis in the event of additional capital contributions by us. In addition, if we contribute additional capital to our Operating Partnership, we will revalue the property of our Operating Partnership to its fair market value (as determined by us) and the capital accounts of the partners will be adjusted to reflect the manner in which the unrealized gain or loss inherent in such property (that has not been reflected in the capital accounts previously) would be allocated among the partners under the terms of the partnership agreement if there were a taxable disposition of such property for such fair market value on the date of the revaluation. Our Operating Partnership may issue preferred partnership interests, in connection with acquisitions of property or otherwise, which could have priority over common partnership interests with respect to distributions from our Operating Partnership, including the partnership interests we own as general partner.

#### ***Redemption Rights***

Under the partnership agreement, the limited partners will receive redemption rights, which will enable them to cause our Operating Partnership to redeem their units of partnership interests in exchange for cash at a price per unit equal to the then current market price per share of our common stock or, at our option, shares of our common stock on a one-for-one basis at any time after the first anniversary of the completion of this offering. The partnership agreement requires that our Operating Partnership be operated in a manner that enables us to satisfy the requirements for being classified as a REIT, to avoid any federal income or excise tax liability imposed by the Internal Revenue Code (other than any federal income tax liability associated with our retained capital gains) and to ensure that our Operating Partnership will not be classified as a “publicly traded partnership” taxable as a corporation under Section 7704 of the Code.

#### ***Distributions***

The partnership agreement will provide that our Operating Partnership will distribute cash from operations (including net sale or refinancing proceeds, but excluding net proceeds from the sale of our Operating Partnership’s property in connection with the liquidation of our Operating Partnership) on a quarterly (or, at our election, more frequent) basis, in amounts determined by us in our sole discretion, to us and the limited partners in proportion to the number of units of partnership interests held.

#### ***Allocations and Tax Matters***

Profits and losses of our Operating Partnership (including depreciation and amortization deductions) for each fiscal year will be allocated to us and the limited partners in proportion to distributions, subject to compliance with the provisions of Internal Revenue Code Sections 704(b) and 704(c) and Treasury Regulations promulgated thereunder.

We will be the tax matters partner of our Operating Partnership and, as such, will have authority to handle tax audits and to make tax elections under the Internal Revenue Code on behalf of our Operating Partnership.

**Term**

Our Operating Partnership will continue until December 31, 2075, or until sooner dissolved upon:

- our bankruptcy, dissolution or withdrawal (unless the limited partners elect to continue our Operating Partnership);
- the sale or other disposition of all or substantially all the assets of our Operating Partnership;
- the redemption of all partnership units (other than those held by us, if any); or
- an election by us in our capacity as the general partner.

**FEDERAL INCOME TAX CONSEQUENCES OF OUR STATUS AS A REIT**

This section summarizes the material federal income tax issues that you, as a stockholder, may consider relevant with respect to an investment in our common stock offered by this prospectus. Because this section is a summary, it does not address all of the tax issues that may be important to you and should not be considered to be tax advice. In addition, this discussion does not address all aspects of taxation that may be relevant to particular stockholders in light of their personal investment or tax circumstances, or to certain types of stockholders that are subject to special treatment under the federal income tax laws, such as:

- dealers in securities;
- financial institutions;
- insurance companies;
- tax exempt entities (except to the extent discussed in “Taxation of Tax-Exempt Stockholders”);
- foreign persons (except to the extent discussed in “Taxation of Non-U.S. Stockholders”);
- stockholders who are subject to the alternative minimum tax;
- stockholders who hold their shares as part of a hedging, straddle, conversion or other risk reduction transaction; or
- stockholders who do not hold their shares as “capital assets” within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the “Code”).

Furthermore, no state, local or foreign tax considerations are addressed in this summary. The federal income tax treatment of REITs is highly technical and complex. The statements in this section and the opinion of Cooley Godward LLP (described below) are based on provisions of the Code, as well as Treasury regulations, administrative rulings and judicial decisions thereunder, all of which are subject to change (possibly with retroactive effect) or to different interpretations. No ruling from the IRS has been or will be requested with respect to any of the tax matters discussed herein.

**We urge you to consult your own tax adviser regarding the specific tax consequences to you of ownership of our common stock and of our election to be taxed as a REIT.**

**Taxation of Gladstone Commercial Corporation**

We intend to conduct our operations in a manner that will permit us to qualify as and elect to be treated as a REIT for federal income tax purposes for the year ending December 31, 2003. We have not requested a ruling from the Internal Revenue Service as to our qualification as a REIT, and no assurance can be given that we will operate in a manner so as to qualify or remain qualified as a REIT.

We have obtained an opinion from Cooley Godward LLP to the effect that, for federal income tax purposes, we will qualify as a REIT, provided that we operate in the manner described in this prospectus and in accordance with the representations set forth in this prospectus and provided that we satisfy the share ownership, income, asset and distribution tests described below.

In addition to the limitations, assumptions and qualifications set forth herein, investors should be aware that Cooley Godward's opinion is based upon customary assumptions and qualifications set forth in such opinion, is conditioned upon certain representations made by us as to factual matters, including representations regarding the nature of our properties and the conduct of our business, and is not binding upon the Internal Revenue Service or any court. Moreover, our qualification and taxation as a REIT depend upon our ability to meet on a continuing basis, through actual annual operating results, certain qualification tests set forth in the federal tax laws. Those qualification tests involve the percentage of income that we earn from specified sources, the percentage of our assets that falls within specified categories, the diversity of our share ownership, and the percentage of our earnings that we distribute. Cooley Godward LLP will not review our compliance with those tests on a continuing basis. Accordingly, no assurance can be given that the actual results of our operations for any particular taxable year will satisfy such requirements. For a discussion of the tax consequences of our failure to qualify as a REIT, see "—Failure to Qualify."

If we qualify as a REIT, we generally will not be subject to federal income tax on the taxable income that we distribute to our stockholders. The benefit of that tax treatment is that it avoids the "double taxation," or taxation at both the corporate and stockholder levels, that generally results under current law from owning shares in a corporation. However, we will be required to pay federal income tax in the following circumstances:

- We will pay federal income tax on taxable income, including net capital gain, that we do not distribute to stockholders during, or within a specified time period after, the calendar year in which the income is earned.
- We may be subject to the "alternative minimum tax" on any items of tax preference and alternative minimum tax adjustment that we do not distribute or allocate to stockholders.
- We will pay income tax at the highest corporate rate on:
  - net income from the sale or other disposition of property acquired through foreclosure ("foreclosure property") that we hold primarily for sale to customers in the ordinary course of business, and
  - other non-qualifying income from foreclosure property.
- We will pay a 100% tax on net income from sales or other dispositions of property, other than foreclosure property, that we hold primarily for sale to customers in the ordinary course of business.
- If we fail to satisfy the 75% gross income test or the 95% gross income test, as described below under "Income Tests," and nonetheless continue to qualify as a REIT because we meet other requirements, we will pay a 100% tax on:
  - the gross income attributable to the greater of the amounts by which we fail the 75% and 95% gross income tests (substituting 90% for 95%, for purposes of calculating the amount by which the 95% test is failed), multiplied by
  - a fraction intended to reflect our profitability.
- If we fail to distribute during a calendar year at least the sum of:
  - 85% of our REIT ordinary income for the year,
  - 95% of our REIT capital gain net income for the year, and
  - any undistributed taxable income from earlier periods,

we will pay a 4% excise tax on the excess of the required distribution over the amount we actually distribute.

- We may elect to retain and pay income tax on our net long-term capital gain. In that case, a U.S. stockholder would be taxed on its proportionate share of our undistributed long-term capital gain (to the extent that we make a timely designation of such gain to the stockholder) and would receive a credit or refund for its proportionate share of the tax we paid.
- We will be subject to a 100% excise tax on transactions with a taxable REIT subsidiary that are not conducted on an arm's-length basis.
- If we acquire any asset from a C corporation, or a corporation that generally is subject to full corporate-level tax, in a merger or other transaction in which we acquire a basis in the asset that is determined by reference either to the C corporation's basis in the asset or to another asset, we will pay tax at the highest regular corporate rate applicable if we recognize gain on the sale or disposition of the asset during the 10-year period after we acquire the asset. The amount of gain on which we will pay tax is the lesser of:
  - the amount of gain that we recognize at the time of the sale or disposition, and
  - the amount of gain that we would have recognized if we had sold the asset at the time we acquired it.

#### **Requirements for Qualification**

A REIT is a corporation, trust or association that meets each of the following requirements:

1. It is managed by one or more trustees or directors;
2. Its beneficial ownership is evidenced by transferable shares or by transferable certificates of beneficial interest;
3. It would be taxable as a domestic corporation, but for the REIT provisions of the federal income tax laws;
4. It is neither a financial institution nor an insurance company subject to special provisions of the federal income tax laws;
5. At least 100 persons are beneficial owners of its shares or ownership certificates;
6. Not more than 50% in value of its outstanding shares or ownership certificates is owned, directly or indirectly, by five or fewer individuals, which the federal income tax laws define to include certain entities, during the last half of any taxable year;
7. It elects to be a REIT, or has made such election for a previous taxable year, and satisfies all relevant filing and other administrative requirements established by the Internal Revenue Service that must be met to elect and maintain REIT status; and
8. It meets certain other qualification tests, described below, regarding the nature of its income and assets.

We must meet requirements 1 through 4 during our entire taxable year and must meet requirement 5 during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months. If we comply with all the requirements for ascertaining the ownership of our outstanding shares in a taxable year and have no reason to know that we violated requirement 6, we will be deemed to have satisfied requirement 6 for that taxable year. For purposes of determining share ownership under requirement 6, an "individual" generally includes a supplemental unemployment compensation benefits plan, a private foundation, or a portion of a trust permanently set aside or used exclusively for charitable purposes. An "individual," however, generally does not include a trust that is a qualified employee pension or profit sharing trust under the federal income tax laws, and beneficiaries of

such a trust will be treated as holding our shares in proportion to their actuarial interests in the trust for purposes of requirement 6. Both requirements 5 and 6 are inapplicable to our first taxable year as a REIT.

We have satisfied requirements 1 through 4. Upon the completion of this offering, we will have issued sufficient shares of common stock with sufficient diversity of ownership to satisfy requirements 5 and 6 above. In addition, our articles of incorporation restrict the ownership and transfer of our shares of capital stock so that we should continue to satisfy these requirements. The provisions of our articles of incorporation restricting the ownership and transfer of the shares of common stock are described in “Certain Provisions of Maryland Law and of our Articles of Incorporation and Bylaws – Restrictions on Ownership of Shares.” We will timely make the election described in 7, above, in the manner required by Treasury Department regulations.

For purposes of satisfying the various REIT qualification requirements, including the income and asset tests described below, some or all of the activities, income and assets of qualified REIT subsidiaries and partnerships we own will be treated as our activities, income and assets.

A corporation that is a “qualified REIT subsidiary” is not treated as a corporation separate from its parent REIT. All assets, liabilities, and items of income, deduction, and credit of a “qualified REIT subsidiary” are treated as assets, liabilities, and items of income, deduction, and credit of the REIT. A “qualified REIT subsidiary” is a corporation that has not elected to be treated as a taxable REIT subsidiary, all of the capital stock of which is owned by the REIT. Thus, in applying the requirements described herein, any “qualified REIT subsidiary” that we own will be ignored, and all assets, liabilities, and items of income, deduction, and credit of such subsidiary will be treated as our assets, liabilities, and items of income, deduction, and credit and our ownership of the stock of such subsidiary will not violate the REIT asset tests discussed below.

Similarly, in the case of a REIT that is a partner in a partnership that has other partners, the REIT is treated as owning its proportionate share of the assets of the partnership and as earning its allocable share of the gross income of the partnership for purposes of the applicable REIT qualification tests. Thus, our proportionate share of the assets, liabilities and items of income of our Operating Partnership and any other partnership, joint venture, or limited liability company that is treated as a partnership for federal income tax purposes in which we acquire an interest, directly or indirectly, will be treated as our assets and gross income for purposes of applying the various REIT qualification requirements.

### **Income Tests**

We must satisfy two gross income tests annually to maintain our qualification as a REIT. First, at least 75% of our gross income, excluding gross income from prohibited transactions, for each taxable year must consist of defined types of income that we derive, directly or indirectly, from investments relating to real property or mortgages on real property or qualified temporary investment income. Qualifying income for purposes of that 75% gross income test generally includes:

- rents from real property;
- interest on debt secured by mortgages on real property, or on interests in real property;
- dividends or other distributions on, and gain from the sale of, shares in other REITs;
- income derived from foreclosure property;
- gain from the sale of real estate assets that are not investment or dealer property; and
- income derived from the temporary investment of new capital that is attributable to the issuance of our shares of capital stock or a public offering of our debt with a maturity date of at least five years and that we receive during the one-year period beginning on the date on which we received such new capital.

Second, in general, at least 95% of our gross income, excluding gross income from prohibited transactions, for each taxable year must consist of income that is qualifying income for purposes of the



75% gross income test, other types of interest and dividends, gains from the sale or disposition of stock or securities, income from certain hedging instruments or any combination of these. The following paragraphs discuss the specific application of the gross income tests to us.

*Rents from Real Property.* Rent that we receive from a tenant will qualify as “rents from real property,” which is qualifying income for purposes of the 75% and 95% gross income tests, only if the following conditions are met.

First, the rent must not be based in whole or in part on the income or profits of any person. Participating rent, however, will qualify as “rents from real property” if it is based on percentages of gross receipts or sales and the percentages:

- are fixed at the time the leases are entered into;
- are not renegotiated during the term of the leases in a manner that has the effect of basing rent on income or profits; and
- conform with normal business practices.

More generally, the rent will not qualify as “rents from real property” if, considering the leases and all the surrounding circumstances, the arrangement does not conform with normal business practices, but is in reality used as a means of basing the rent on income or profits. We will not charge rent for any property that is based in whole or in part on the income or profits of any person, except by reason of being based on a fixed percentage of gross revenues, as described above.

Second, we must not own, actually or constructively, 10% or more of the stock (by vote or value) or the assets or net profits of any tenant (a “related party tenant”) other than a “taxable REIT subsidiary” or “TRS.” See “Other Tax Consequences — Taxable REIT Subsidiaries.” In addition, the constructive ownership rules generally provide that, if 10% or more in value of our shares is owned, directly or indirectly, by or for any person, we are considered as owning the stock owned, directly or indirectly, by or for such person. Because the constructive ownership rules are broad and it is not possible to continually monitor direct and indirect transfers of our shares, no absolute assurance can be given that such transfers or other events of which we have no knowledge will not cause us to own constructively 10% or more of a tenant other than a TRS at some future date.

As described above, we may own up to 100% of the stock of one or more TRSs. As an exception to the related party tenant rule described in the preceding paragraph, rent that we receive from a TRS will qualify as “rents from real property” as long as (1) the TRS is a qualifying TRS (see “Other Tax Consequences — Taxable REIT Subsidiaries”), (2) at least 90% of the leased space in the property is leased to persons other than TRSs and related party tenants, and (3) the amount paid by the TRS to rent space at the property is substantially comparable to rents paid by other tenants of the property for comparable space.

Third, the rent attributable to the personal property leased in connection with the lease of a property must not be greater than 15% of the total rent received under the lease. The rent attributable to the personal property contained in a property is the amount that bears the same ratio to total rent for the property in the taxable year as the average of the fair market values of the personal property at the beginning and at the end of the taxable year bears to the average of the aggregate fair market values of both the real and personal property contained in the property at the beginning and at the end of such taxable year (the “personal property ratio”). We believe that the personal property ratio of the properties that we intend to acquire will be less than 15% or that any income attributable to excess personal property will not jeopardize our ability to qualify as a REIT. There can be no assurance, however, that the Internal Revenue Service would not challenge our calculation of a personal property ratio, or that a court would not uphold such assertion. If such a challenge were successfully asserted, we could fail to satisfy the 75% or 95% gross income test and thus lose our REIT status.

Fourth, we cannot furnish or render noncustomary services to the tenants of our properties, or manage or operate our properties, other than through an independent contractor who is adequately compensated

and from whom we do not derive or receive any income. However, we may provide services directly to our tenants, if the services are “usually or customarily rendered” in connection with the rental of space for occupancy only and are not considered to be provided for the tenants’ convenience. In addition, we may provide a minimal amount of “noncustomary” services directly to the tenants of a property as long as our income from the services does not exceed 1% of our income from the related property. We may employ a TRS, which may be wholly or partially owned by us, to provide both customary and noncustomary services to our tenants without causing the rents from the related properties to fail to qualify as “rents from real property.” Any amounts we receive from a TRS with respect to such TRS’s provision of noncustomary services will, however, be non-qualified income under the 75% gross income tax and, except to the extent received through the payment of dividends, the 95% gross income test. Finally, we may own up to 100% of the stock of one or more TRSs, which may provide noncustomary services to our tenants without tainting our rents from the related properties. We do not intend to perform any services other than customary ones for our tenants, other than services provided through independent contractors or TRSs.

If a portion of the rent that we receive from a property does not qualify as “rents from real property” because the rent attributable to personal property exceeds 15% of the total rent for a taxable year, only that portion of the rent that is attributable to personal property will not be qualifying income for purposes of either the 75% or 95% gross income test. Thus, if such rent attributable to personal property, plus any other income that is nonqualifying income for purposes of the 95% gross income test, during a taxable year exceeds 5% of our gross income during the year, we would lose our REIT status. If, however, the rent from a particular property does not qualify as “rents from real property” because either (1) the rent is considered based on the income or profits of the related tenant, (2) the tenant either is a related party tenant or fails to qualify for the exception to the related party tenant rule for qualifying TRSs, or (3) we furnish noncustomary services to the tenants of the property, or manage or operate the property, other than through a qualifying independent contractor or a TRS, none of the rent from that property would qualify as “rents from real property.” In that case, we might lose our REIT status because we would be unable to satisfy either the 75% or 95% gross income test.

In addition to rent, our tenants will be required to pay certain additional charges. To the extent that such additional charges represent reimbursements of amounts that we are obligated to pay to third parties, such as a tenant’s proportionate share of a property’s operational or capital expenses, such amounts are not included in gross income for purposes of the income tests because reimbursements are essentially loan repayments. Penalties for nonpayment or late payment of such amounts may also be excluded from gross income. However, to the extent that such charges are not excluded from gross income, they instead should be treated as interest that qualifies for the 95% gross income test.

*Interest.* The term “interest” generally does not include any amount received or accrued, directly or indirectly, if the determination of such amount depends in whole or in part on the income or profits of any person. However, an amount received or accrued generally will not be excluded from the term “interest” solely by being based on a fixed percentage or percentages of gross receipts or sales. Furthermore, to the extent that interest from a loan that is based on the residual cash proceeds from the sale of the property securing the loan constitutes a “shared appreciation provision,” income attributable to such participation feature will be treated as gain from the sale of the secured property.

*Prohibited Transactions.* A REIT will incur a 100% tax on the net income derived from any sale or other disposition of property, other than foreclosure property, that the REIT holds primarily for sale to customers in the ordinary course of a trade or business. We believe that none of our assets will be held primarily for sale to customers and that a sale of any of our assets will not be in the ordinary course of our business. Whether a REIT holds an asset “primarily for sale to customers in the ordinary course of a trade or business” depends, however, on the facts and circumstances surrounding a particular transaction. Nevertheless, we will attempt to comply with the terms of safe-harbor provisions in the federal income tax laws prescribing when an asset sale will not be characterized as a prohibited transaction. We cannot assure you, however, that we can comply with the safe-harbor provisions or that we will avoid owning property that may be characterized as property that we hold “primarily for sale to customers in the ordinary course of a trade or business.”

*Foreclosure Property.* We will be subject to tax at the maximum corporate rate on any income from foreclosure property, other than income that otherwise would be qualifying income for purposes of the 75% gross income test, less expenses directly connected with the production of that income. However, gross income from foreclosure property will qualify under the 75% and 95% gross income tests. Foreclosure property generally is any real property, including interests in real property, and any personal property incident to such real property:

- that is acquired by a REIT as the result of the REIT having bid on such property at foreclosure, or having otherwise reduced such property to ownership or possession by agreement or process of law, after there was a default or default was imminent on a lease of such property or on indebtedness that such property secured;
- for which the related loan was acquired by the REIT at a time when the default was not imminent or anticipated; and
- for which the REIT makes a proper election to treat the property as foreclosure property.

*Hedging Transactions.* From time to time, we or our Operating Partnership may enter into hedging transactions with respect to one or more of our assets or liabilities. Our hedging activities may include entering into interest rate swaps, caps, and floors, options to purchase such items, and futures and forward contracts. To the extent that we or our Operating Partnership enter into an interest rate swap or cap contract, option, futures contract, forward rate agreement, or any similar financial instrument to hedge our indebtedness incurred to acquire or carry “real estate assets,” any periodic income or gain from the disposition of such contract should be qualifying income for purposes of the 95% gross income test, but not the 75% gross income test. To the extent that we or our Operating Partnership hedges with other types of financial instruments, or in other situations, it is not entirely clear how the income from those transactions will be treated for purposes of the gross income tests. We intend to structure any hedging transactions in a manner that does not jeopardize our status as a REIT.

*Failure to Satisfy Gross Income Tests.* If we fail to satisfy one or both of the gross income tests for any taxable year, we nevertheless may qualify as a REIT for that year if we qualify for relief under certain provisions of the federal income tax laws. Those relief provisions generally will be available if:

- our failure to meet such tests is due to reasonable cause and not due to willful neglect;
- we attach a schedule of the sources of our income to our federal income tax return; and
- any incorrect information on the schedule was not due to fraud with intent to evade tax.

We cannot predict, however, whether in all circumstances we would qualify for the relief provisions. In addition, as discussed above in “Taxation of Gladstone Commercial Corporation,” even if the relief provisions apply, we would incur a 100% tax on the gross income attributable to the greater of the amounts by which we fail the 75% and 95% gross income tests (substituting 90% for 95%, for purposes of calculating the amount by which the 95% test is failed), multiplied by a fraction intended to reflect our profitability.

#### **Asset Tests**

To maintain our qualification as a REIT, we also must satisfy the following asset tests at the end of each quarter of each taxable year. First, at least 75% of the value of our total assets, including assets held by any qualified REIT subsidiaries and our allocable share of the assets held by any partnerships or limited liability companies in which we hold an interest, must consist of:

- cash or cash items, including certain receivables;
- government securities;
- interests in real property, including leaseholds and options to acquire real property and leaseholds;
- interests in mortgage loans on real property;

- stock in other REITs; and
- investments in stock or debt instruments during the one-year period following our receipt of new capital that we raise through equity offerings or offerings of debt with at least a five-year term.

Second, of our investments not included in the 75% asset class, the value of our interest in any one issuer's securities may not exceed 5% of the value of our total assets. Third, we may not own more than 10% of the voting power or value of any one issuer's outstanding securities. Fourth, no more than 20% of the value of our total assets may consist of the securities of one or more TRSs. Fifth, no more than 25% of the value of our total assets may consist of the securities of TRSs and other assets that are not qualifying assets for purposes of the 75% asset test.

For purposes of the second and third asset tests, the term "securities" does not include stock in another REIT, equity or debt securities of a qualified REIT subsidiary or a TRS, mortgage loans that constitute real estate assets, or equity interests in a partnership. The term "securities," however, generally includes debt securities issued by a partnership or another REIT, except that certain "straight debt" securities are not treated as "securities" for purposes of the 10% value test (for example, qualifying debt securities of a corporation of which we own no equity interest or of a partnership if we own at least a 20% profits interest in the partnership).

We will monitor the status of our assets for purposes of the various asset tests and will manage our portfolio in order to comply at all times with such tests. If we fail to satisfy the asset tests at the end of a calendar quarter, we will not lose our REIT status if:

- we satisfied the asset tests at the end of the preceding calendar quarter; and
- the discrepancy between the value of our assets and the asset test requirements arose from changes in the market values of our assets and was not wholly or partly caused by the acquisition of one or more non-qualifying assets.

If we did not satisfy the condition described in the second item above, we still could avoid disqualification by eliminating any discrepancy within 30 days after the close of the calendar quarter in which it arose.

#### **Distribution Requirements**

Each taxable year, we must distribute dividends, other than capital gain dividends and deemed distributions of retained capital gain, to our stockholders in an aggregate amount at least equal to:

- the sum of
  - 90% of our "REIT taxable income," computed without regard to the dividends paid deduction and our net capital gain or loss, and
  - 90% of our after-tax net income, if any, from foreclosure property, minus
- the sum of certain items of non-cash income over 5% of "REIT taxable income."

We must pay such distributions in the taxable year to which they relate, or in the following taxable year if we declare the distribution before we timely file our federal income tax return for the year and pay the distribution on or before the first regular dividend payment date after such declaration.

We will pay federal income tax on taxable income, including net capital gain, that we do not distribute to stockholders. Furthermore, if we fail to distribute during a calendar year, or by the end of January following the calendar year in the case of distributions with declaration and record dates falling in the last three months of the calendar year, at least the sum of:

- 85% of our REIT ordinary income for such year,
- 95% of our REIT capital gain income for such year, and

- any undistributed taxable income from prior periods,

then we will incur a 4% nondeductible excise tax on the excess of such required distribution over the amounts we actually distribute. We may elect to retain and pay income tax on the net long-term capital gain we receive in a taxable year. See “Taxation of Taxable U.S. Stockholders.” If we so elect, we will be treated as having distributed any such retained amount for purposes of the 4% excise tax described above. We intend to make timely distributions sufficient to satisfy the annual distribution requirements and to avoid corporate income tax and the 4% excise tax.

It is possible that, from time to time, we may experience timing differences between the actual receipt of income and actual payment of deductible expenses and the inclusion of that income and deduction of such expenses in arriving at our REIT taxable income. For example, we may not deduct recognized capital losses from our “REIT taxable income.” Further, it is possible that, from time to time, we may be allocated a share of net capital gain attributable to the sale of depreciated property that exceeds our allocable share of cash attributable to that sale. As a result of the foregoing, we may have less cash than is necessary to distribute all of our taxable income and thereby avoid corporate income tax and the excise tax imposed on certain undistributed income. In such a situation, we may need to borrow funds or issue additional shares of capital stock in order to make distributions necessary to maintain our REIT status.

Under certain circumstances, we may be able to correct a failure to meet the distribution requirement for a year by paying “deficiency dividends” to our stockholders in a later year. We may include such deficiency dividends in our deduction for dividends paid for the earlier year. Although we may be able to avoid income tax on amounts distributed as deficiency dividends, we will be required to pay interest to the Internal Revenue Service based upon the amount of any deduction we take for deficiency dividends.

### **Recordkeeping Requirements**

We must maintain certain records in order to qualify as a REIT. In addition, to avoid a monetary penalty, we must request on an annual basis information from our stockholders designed to disclose the actual ownership of our outstanding shares of capital stock. We intend to comply with these requirements. Any record stockholder who, upon our request, does not provide us with required information concerning actual ownership of the shares is required to include specified information relating to his, her or its or its shares in his, her or its or its federal income tax return. We also must maintain, within the Internal Revenue District in which we are required to file our federal income tax return, permanent records showing the information we have received about the actual ownership of our shares and a list of those persons failing or refusing to comply with our demand.

### **Failure to Qualify**

If we fail to qualify as a REIT in any taxable year, and no relief provision applies, we would be subject to federal income tax and any applicable alternative minimum tax on our taxable income at regular corporate rates. In calculating our taxable income in a year in which we fail to qualify as a REIT, we would not be able to deduct amounts distributed to stockholders. In fact, we would not be required to distribute any amounts to stockholders in that year. In such event, to the extent of our current and accumulated earnings and profits, all distributions to stockholders would be taxable as ordinary income. Subject to certain limitations of the federal income tax laws, corporate stockholders might be eligible for the dividends received deduction. Unless we qualified for relief under specific statutory provisions, we also would be disqualified from taxation as a REIT for the four taxable years following the year during which we ceased to qualify as a REIT. We cannot predict whether in all circumstances we would qualify for such statutory relief. See “Risk Factors – Loss of our tax status as a REIT would have significant adverse consequences to us and the value of our common stock.”

### **Sale-Leaseback Transactions**

Many of our investments will be in the form of sale-leaseback transactions. In most instances, depending on the economic terms of the transaction, we will be treated for federal income tax purposes as

either the owner of the property or the holder of a debt secured by the property. We do not expect to request an opinion of counsel concerning the status of any leases of properties as true leases for federal income tax purposes.

The Internal Revenue Service may take the position that specific sale-leaseback transactions we may treat as true leases are not true leases for federal income tax purposes but are, instead, financing arrangements or loans. We may also structure some sale-leaseback transactions as loans. In this event, for purposes of the asset tests and the 75% income test, each such loan likely would be viewed as secured by real property to the extent of the fair market value of the underlying property. It is expected that, for this purpose, the fair market value of the underlying property would be determined without taking into account our lease. If a sale-leaseback transaction we treat as a lease were recharacterized as a loan, we might fail to satisfy the asset tests or the income tests and consequently lose our REIT status effective with the year of recharacterization. Alternatively, the amount of our REIT taxable income could be recalculated which could cause us to fail one or both of the income tests and, consequently, to lose our REIT status.

#### **Method of Accounting**

In computing our REIT taxable income, we will use the accrual method of accounting and depreciate depreciable property under the alternative depreciation system. We will be required to file an annual federal income tax return, which, like other corporate returns, is subject to Internal Revenue Service examination. Because the tax law requires us to make many judgments regarding the proper treatment of a transaction or an item of income or deduction, it is possible that the Internal Revenue Service will challenge positions we take in computing our REIT taxable income and its distributions. Issues could arise, for example, with respect to the allocation of the purchase price of properties between depreciable or amortizable assets and nondepreciable or non-amortizable assets such as land and the current deductibility of fees paid to our Adviser or its affiliates. Were the Internal Revenue Service to challenge successfully our characterization of a transaction or determination of our REIT taxable income, we could be found not to have satisfied a requirement for qualification as a REIT and mitigation provisions might not apply. If, as a result of a challenge, we are determined not to have satisfied the 90% distribution test, we would be disqualified as a REIT (unless we were to pay a deficiency distribution and pay interest and a penalty) as provided by the Code. A deficiency distribution cannot be used to satisfy the 90% distribution test if the failure to meet the test was not due to a later adjustment to our income by the Internal Revenue Service.

#### **Taxation of Taxable U.S. Stockholders**

As long as we qualify as a REIT, a taxable "U.S. stockholder" must take into account as ordinary income distributions made out of our current or accumulated earnings and profits that we do not designate as capital gain dividends or retained long-term capital gain. As long as we qualify as a REIT, then distributions will not be eligible for the dividends received deduction otherwise generally available to corporations or for the special 15% tax rate on dividends under the recently enacted Jobs and Growth Tax Relief Reconciliation Act of 2003. The term "U.S. stockholder" means a holder of our common stock that, for United States federal income tax purposes, is:

- a citizen or resident of the United States;
- a corporation or partnership (including an entity treated as a corporation or partnership for U.S. federal income tax purposes) created or organized under the laws of the United States or of a political subdivision of the United States unless, in the case of a partnership, treasury regulations provide otherwise;
- an estate whose income is subject to U.S. federal income taxation regardless of its source; or
- any trust if (1) a U.S. court is able to exercise primary supervision over the administration of such trust and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) it has a valid election in place to be treated as a U.S. person.

Distributions that we properly designate as capital gain dividend will be taxable to our taxable U.S. stockholders as gain from the sale of a capital asset, to the extent that such gain does not exceed our actual net capital gain for the taxable year. Such gain is taxable as long-term capital gain without regard to the period for which the U.S. stockholder has held its common stock. We generally will designate our capital gain dividends as either 15% or 25% rate distributions. A corporate U.S. stockholder, however, may be required to treat up to 20% of certain capital gain dividends as ordinary income.

We may elect to retain and pay income tax on the net long-term capital gain that we receive in a taxable year. In that case, a U.S. stockholder would include its proportionate share of our undistributed long-term capital gain in computing its long-term capital gains in its return for its taxable year in which the last day of our taxable year falls. The U.S. stockholder would receive a credit or refund for its proportionate share of the tax we paid. The U.S. stockholder would increase the basis in its common shares by the amount of its proportionate share of our undistributed long-term capital gain, minus its share of the tax we paid.

A U.S. stockholder will not incur tax on a distribution, not designated as a capital gain distribution, in excess of our current and accumulated earnings and profits if the distribution does not exceed the adjusted basis of the U.S. stockholder's shares of common stock. Instead, the distribution will reduce the stockholder's adjusted basis of such common stock. A U.S. stockholder will recognize a distribution, not designated as a capital gain distribution, in excess of both our current and accumulated earnings and profits and the U.S. stockholder's adjusted basis in his or her shares of common stock as long-term capital gain, or short-term capital gain if the shares of common stock have been held for one year or less, assuming the shares of common stock are a capital asset in the hands of the U.S. stockholder. In addition, if we declare a distribution in October, November or December of any year that is payable to a U.S. stockholder of record on a specified date in any such month, such distribution shall be treated as both paid by us and received by the U.S. stockholder on December 31 of such year, provided that we actually pay the distribution during January of the following calendar year.

Stockholders may not include in their individual income tax returns any of our net operating losses or capital losses. Instead, these losses are generally carried over by us for potential offset against our future income. Taxable distributions from us and gain from the disposition of the shares of common stock will not be treated as passive activity income and, therefore, stockholders generally will not be able to apply any "passive activity losses," such as losses from certain types of limited partnerships in which the stockholder is a limited partner, against such income. In addition, taxable distributions from us generally will be treated as investment income for purposes of the investment interest limitations. However, gain from the disposition of shares of our common stock may not be treated as investment income depending on a stockholder's particular situation. Stockholders will be required to include in their income for each taxable year as ordinary income, return of capital and capital gain the amounts that we designate in a written notice mailed after the close of such taxable year.

#### **Taxation of U.S. Stockholders on the Disposition of Shares of Our Common Stock**

In general, a U.S. stockholder must treat any gain or loss realized upon a taxable disposition of shares of our common stock as long-term capital gain or loss if the U.S. stockholder has held the shares of common stock for more than one year and otherwise as short-term capital gain or loss. However, a U.S. stockholder must treat any loss upon a sale or exchange of common stock held by such stockholder for six months or less as a long-term capital loss to the extent of capital gain dividends and any other actual or deemed distributions from us that such U.S. stockholder treats as long-term capital gain. All or a portion of any loss that a U.S. stockholder realizes upon a taxable disposition of the shares of common stock may be disallowed if the U.S. stockholder purchases other shares of our common stock within 30 days before or after the disposition.

## Capital Gains and Losses

The tax rate differential between capital gain and ordinary income for non-corporate taxpayers may be significant. A taxpayer generally must hold a capital asset for more than one year for gain or loss derived from its sale or exchange to be treated as long-term capital gain or loss. Under recently enacted legislation, the highest marginal individual income tax rate is 35% for years ending after December 31, 2002 and beginning before January 1, 2006, at which time the rates revert to those in effect under prior law. For taxable years ending after May 6, 2003 and beginning on or before December 31, 2008, the maximum tax rate on long-term capital gain applicable to non-corporate taxpayers is 15% for sales and exchanges of assets held for more than one year, if the sale or exchange occurs on or after May 6, 2003. The maximum tax rate on long-term capital gain from the sale or exchange of "section 1250 property," or depreciable real property, is 25% to the extent that such gain would have been treated as ordinary income if the property were "section 1245 property." With respect to distributions that we designate as capital gain dividends and any retained capital gain that we are deemed to distribute, we generally may designate whether such a distribution is taxable to our non-corporate stockholders at a 15% or 25% rate. In addition, the characterization of income as capital gain or ordinary income may affect the deductibility of capital losses. A non-corporate taxpayer may deduct capital losses not offset by capital gains against its ordinary income only up to a maximum annual amount of \$3,000. A non-corporate taxpayer may carry forward unused capital losses indefinitely. A corporate taxpayer must pay tax on its net capital gain at ordinary corporate rates. A corporate taxpayer can deduct capital losses only to the extent of capital gains, with unused losses being carried back three years and forward five years.

## Information Reporting Requirements and Backup Withholding

We will report to our stockholders and to the Internal Revenue Service the amount of distributions we pay during each calendar year and the amount of tax we withhold, if any. Under the backup withholding rules, a stockholder may be subject to backup withholding at a rate of up to 28% with respect to distributions unless the holder:

- is a corporation or comes within certain other exempt categories and, when required, demonstrates this fact; or
- provides a taxpayer identification number, certifies as to no loss of exemption from backup withholding, and otherwise complies with the applicable requirements of the backup withholding rules.

A stockholder who does not provide us with its correct taxpayer identification number also may be subject to penalties imposed by the Internal Revenue Service. Any amount paid as backup withholding may be claimed as a credit against the stockholder's income tax liability. In addition, we may be required to withhold a portion of capital gain distributions to any stockholders who fail to certify their non-foreign status to us. For a discussion of the backup withholding rules as applied to non-U.S. stockholders, see "Taxation of Non-U.S. Stockholders."

## Taxation of Tax-Exempt Stockholders

Tax-exempt entities, including qualified employee pension and profit sharing trusts and individual retirement accounts, generally are exempt from federal income taxation. However, they are subject to taxation on their unrelated business taxable income. While many investments in real estate generate unrelated business taxable income, the Internal Revenue Service has issued a ruling that dividend distributions from a REIT to an exempt employee pension trust do not constitute unrelated business taxable income so long as the exempt employee pension trust does not otherwise use the shares of the REIT in an unrelated trade or business of the pension trust. Based on that ruling, amounts that we distribute to tax-exempt stockholders generally should not constitute unrelated business taxable income. However, if a tax-exempt stockholder were to finance its acquisition of our common stock with debt, a portion of the income that it receives from us would constitute unrelated business taxable income pursuant to the "debt-financed property" rules. Furthermore, social clubs, voluntary employee benefit associations,



supplemental unemployment benefit trusts and qualified group legal services plans that are exempt from taxation under special provisions of the federal income tax laws are subject to different unrelated business taxable income rules, which generally will require them to characterize distributions that they receive from us as unrelated business taxable income. Finally, in certain circumstances, a qualified employee pension or profit sharing trust that owns more than 10% of our shares of common stock must treat a percentage of the dividends that it receives from us as unrelated business taxable income. Such percentage is equal to the gross income we derive from an unrelated trade or business, determined as if we were a pension trust, divided by our total gross income for the year in which we pay the dividends. That rule applies to a pension trust holding more than 10% of our shares only if the percentage of our dividends that the tax-exempt trust must treat as unrelated business taxable income is at least 5% and we constitute a “pension-held REIT.” We would be a pension-held REIT only if:

- we qualify as a REIT by reason of the modification of the rule requiring that no more than 50% of our shares of capital stock be owned by five or fewer individuals that allows the beneficiaries of the pension trust to be treated as holding our shares of capital stock in proportion to their actuarial interests in the pension trust; and
- either:
  - one pension trust owns more than 25% of the value of our shares of capital stock; or
  - a group of pension trusts individually holding more than 10% of the value of our shares of capital stock collectively owns more than 50% of the value of our shares of capital stock.

We do not expect to be a pension-held REIT.

#### **Taxation of Non-U.S. Stockholders**

The rules governing U.S. federal income taxation of nonresident alien individuals, foreign corporations, foreign partnerships, and other foreign stockholders are complex. This section is only a summary of such rules. **We urge non-U.S. stockholders to consult their own tax advisers to determine the impact of federal, state and local income tax laws on ownership of our common stock, including any reporting requirements.**

A non-U.S. stockholder that receives a distribution that is not attributable to gain from our sale or exchange of U.S. real property interests, as defined below, and that we do not designate as a capital gain dividend or retained capital gain, will recognize ordinary income to the extent that we pay the distribution out of our current or accumulated earnings and profits. A withholding tax equal to 30% of the gross amount of the distribution ordinarily will apply unless an applicable tax treaty reduces or eliminates the tax. However, if such a distribution is treated as effectively connected with the non-U.S. stockholder’s conduct of a U.S. trade or business, the non-U.S. stockholder generally will be subject to federal income tax on the distribution at graduated rates, in the same manner as U.S. stockholders are taxed on distributions, and also may be subject to the 30% branch profits tax in the case of a corporate non-U.S. stockholder. We plan to withhold U.S. income tax at the rate of 30% on the gross amount of any distribution paid to a non-U.S. stockholder unless either:

- a lower treaty rate applies and the non-U.S. stockholder provides us with an IRS Form W-8BEN evidencing eligibility for that reduced rate with us; or
- the non-U.S. stockholder provides us with an IRS Form W-8ECI claiming that the distribution is effectively connected income.

A non-U.S. stockholder will not incur tax on a distribution in excess of our current and accumulated earnings and profits if the excess portion of the distribution does not exceed the adjusted basis of its shares of common stock. Instead, the excess portion of the distribution will reduce the adjusted basis of those shares. A non-U.S. stockholder will be subject to tax on a distribution that exceeds both our current and accumulated earnings and profits and the adjusted basis of its shares of common stock, if the non-U.S. stockholder otherwise would be subject to tax on gain from the sale or disposition of its shares of common

stock, as described below. Because we generally cannot determine at the time we make a distribution whether or not the distribution will exceed our current and accumulated earnings and profits, we normally will withhold tax on the entire amount of any distribution at the same rate as we would withhold on an ordinary income dividend. However, a non-U.S. stockholder may obtain a refund of amounts that we withhold if we later determine that a distribution in fact exceeded our current and accumulated earnings and profits.

We must withhold 10% of any distribution that exceeds our current and accumulated earnings and profits. Consequently, although we intend to withhold at a rate of 30% on the entire amount of any distribution, to the extent that we do not do so, we will withhold at a rate of 10% on any portion of a distribution not subject to withholding at a rate of 30%.

For any year in which we qualify as a REIT, a non-U.S. stockholder will incur tax on distributions that are attributable to gain from our sale or exchange of “U.S. real property interests” under special provisions of the federal income tax laws known as “FIRPTA.” The term “U.S. real property interests” includes interests in real property and shares in corporations at least 50% of whose assets consists of interests in real property. Under those rules, a non-U.S. stockholder is taxed on distributions attributable to gain from sales of U.S. real property interests as if the gain were effectively connected with a U.S. business of the non-U.S. stockholder. A non-U.S. stockholder thus would be taxed on such a distribution at the normal capital gain rates applicable to U.S. stockholders, subject to applicable alternative minimum tax and a special alternative minimum tax in the case of a nonresident alien individual. A non-U.S. corporate stockholder not entitled to treaty relief or exemption also may be subject to the 30% branch profits tax on such a distribution. We must withhold 35% of any distribution that we could designate as a capital gain dividend. A non-U.S. stockholder may receive a credit against its U.S. tax liability for the amount we withhold.

A non-U.S. stockholder generally will not incur tax under FIRPTA with respect to gain on a sale of shares of our common stock as long as at all times non-U.S. persons hold, directly or indirectly, less than 50% in value of our shares of capital stock. We cannot assure you that that test will be met. However, a non-U.S. stockholder that owned, actually or constructively, 5% or less of our common stock at all times during a specified testing period will not incur tax under FIRPTA on a disposition of the shares of common stock if the shares are “regularly traded” on an established securities market. Because it is expected that our common stock will be regularly traded on an established securities market, a non-U.S. stockholder should not incur tax under FIRPTA with respect to gain on a sale of our common stock unless it owns, actually or constructively, more than 5% of the common stock. If the gain on the sale of the common stock were taxed under FIRPTA, a non-U.S. stockholder would be taxed on that gain in the same manner as U.S. stockholders subject to applicable alternative minimum tax, a special alternative minimum tax in the case of nonresident alien individuals, and the possible application of the 30% branch profits tax in the case of non-U.S. corporations.

Furthermore, a non-U.S. stockholder generally will incur tax on gain not subject to FIRPTA if:

- the gain is effectively connected with the non-U.S. stockholder’s U.S. trade or business, in which case the non-U.S. stockholder will be subject to the same treatment as U.S. stockholders with respect to such gain; or
- the non-U.S. stockholder is a nonresident alien individual who was present in the U.S. for 183 days or more during the taxable year and has a “tax home” in the United States, in which case the non-U.S. stockholder will incur a 30% tax on his or her capital gains.

## OTHER TAX CONSEQUENCES

### Tax Aspects of Our Investments in our Operating Partnership

The following discussion summarizes certain federal income tax considerations applicable to our direct or indirect investments in our Operating Partnership and any subsidiary partnerships or limited liability companies that we form or acquire (each individually a “Partnership” and, collectively, the “Partnerships”). The discussion does not cover state or local tax laws or any federal tax laws other than income tax laws.

*Classification as Partnerships.* We will include in our income our distributive share of each Partnership’s income and we will deduct our distributive share of each Partnership’s losses only if such Partnership is classified for federal income tax purposes as a partnership (or an entity that is disregarded for federal income tax purposes if the entity has only one owner or member), rather than as a corporation or an association taxable as a corporation. An organization with at least two owners or members will be classified as a partnership, rather than as a corporation, for federal income tax purposes if it:

- is treated as a partnership under the Treasury regulations relating to entity classification (the “check-the-box regulations”); and
- is not a “publicly traded” partnership.

Under the check-the-box regulations, an unincorporated entity with at least two owners or members may elect to be classified either as an association taxable as a corporation or as a partnership. If such an entity fails to make an election, it generally will be treated as a partnership for federal income tax purposes. Each Partnership intends to be classified as a partnership for federal income tax purposes (or an entity that is disregarded for federal income tax purposes if the entity has only one owner or member), and no Partnership will elect to be treated as an association taxable as a corporation under the check-the-box regulations.

A publicly traded partnership is a partnership whose interests are traded on an established securities market or are readily tradable on a secondary market or the substantial equivalent thereof. A publicly traded partnership will not, however, be treated as a corporation for any taxable year if 90% or more of the partnership’s gross income for such year consists of certain passive-type income, including real property rents, gains from the sale or other disposition of real property, interest, and dividends (the “90% passive income exception”).

Treasury regulations (the “PTP regulations”) provide limited safe harbors from the definition of a publicly traded partnership. Pursuant to one of those safe harbors (the “private placement exclusion”), interests in a partnership will not be treated as readily tradable on a secondary market or the substantial equivalent thereof if (1) all interests in the partnership were issued in a transaction or transactions that were not required to be registered under the Securities Act of 1933, as amended, and (2) the partnership does not have more than 100 partners at any time during the partnership’s taxable year. In determining the number of partners in a partnership, a person owning an interest in a partnership, grantor trust, or S corporation that owns an interest in the partnership is treated as a partner in such partnership only if (1) substantially all of the value of the owner’s interest in the entity is attributable to the entity’s direct or indirect interest in the partnership and (2) a principal purpose of the use of the entity is to permit the partnership to satisfy the 100-partner limitation. We currently intend that each Partnership will qualify for the private placement exclusion.

We have not requested, and do not intend to request, a ruling from the Internal Revenue Service that the Partnerships will be classified as partnerships for federal income tax purposes. If for any reason a Partnership were taxable as a corporation, rather than as a partnership, for federal income tax purposes, we likely would not be able to qualify as a REIT. See “Federal Income Tax Consequences of our Status as a REIT — Income Tests” and “— Asset Tests.” In addition, any change in a Partnership’s status for tax purposes might be treated as a taxable event, in which case we might incur tax liability without any related cash distribution. See “Federal Income Tax Consequences of our Status as a REIT — Distribution Requirements.” Further, items of income and deduction of such Partnership would not pass through to its

partners, and its partners would be treated as stockholders for tax purposes. Consequently, such Partnership would be required to pay income tax at corporate rates on its net income, and distributions to its partners would constitute dividends that would not be deductible in computing such Partnership's taxable income.

### **Income Taxation of the Partnerships and Their Partners**

*Partners, Not the Partnerships, Subject to Tax.* A partnership is not a taxable entity for federal income tax purposes. Rather, we are required to take into account our allocable share of each Partnership's income, gains, losses, deductions, and credits for any taxable year of such Partnership ending within or with our taxable year, without regard to whether we have received or will receive any distribution from such Partnership.

*Partnership Allocations.* Although a partnership agreement generally will determine the allocation of income and losses among partners, such allocations may be disregarded for tax purposes if they do not comply with certain provisions of the federal income tax laws governing partnership allocations. If an allocation is not recognized for federal income tax purposes, the item subject to the allocation will be reallocated in accordance with the partners' interests in the partnership, which will be determined by taking into account all of the facts and circumstances relating to the economic arrangement of the partners with respect to such item. We expect that each Partnership's allocations of taxable income, gain, and loss will be respected for U.S. federal income tax purposes.

*Tax Allocations With Respect to Contributed Properties.* Income, gain, loss, and deduction attributable to appreciated or depreciated property that is contributed to a partnership in exchange for an interest in the partnership must be allocated in a manner such that the contributing partner is charged with, or benefits from, respectively, the unrealized gain or unrealized loss associated with the property at the time of the contribution. The amount of such unrealized gain or unrealized loss ("built-in gain" or "built-in loss") is generally equal to the difference between the fair market value of the contributed property at the time of contribution and the adjusted tax basis of such property at the time of contribution (a "book-tax difference"). Such allocations are solely for federal income tax purposes and do not affect the book capital accounts or other economic or legal arrangements among the partners. The U.S. Treasury Department has issued regulations requiring partnerships to use a "reasonable method" for allocating items with respect to which there is a book-tax difference and outlining several reasonable allocation methods.

Under our Operating Partnership's partnership agreement, depreciation or amortization deductions of the operating partnership generally will be allocated among the partners in accordance with their respective interests in our Operating Partnership, except to the extent that our Operating Partnership is required under the federal income tax laws governing partnership allocations to use a method for allocating tax depreciation deductions attributable to contributed properties. In addition, gain or loss on the sale of a property that has been contributed, in whole or in part, to our Operating Partnership will be specially allocated to the contributing partners to the extent of any built-in gain or loss with respect to such property for federal income tax purposes.

*Basis in Partnership Interest.* Our adjusted tax basis in our partnership interest in our Operating Partnership generally will be equal to:

- the amount of cash and the basis of any other property contributed by us to our Operating Partnership;
- increased by our allocable share of our Operating Partnership's income and our allocable share of indebtedness of our Operating Partnership; and
- reduced, but not below zero, by our allocable share of our Operating Partnership's loss and the amount of cash distributed to us, and by constructive distributions resulting from a reduction in our share of indebtedness of our Operating Partnership.

If the allocation of our distributive share of our Operating Partnership's loss would reduce the adjusted tax basis of our partnership interest below zero, the recognition of such loss will be deferred until such time as the recognition of such loss would not reduce our adjusted tax basis below zero. To the extent that our Operating Partnership's distributions, or any decrease in our share of the indebtedness of our Operating Partnership, which is considered a constructive cash distribution to the partners, reduce our adjusted tax basis below zero, such distributions will constitute taxable income to us. Such distributions and constructive distributions normally will be characterized as long-term capital gain.

*Depreciation Deductions Available to Our Operating Partnership.* To the extent that our Operating Partnership acquires its properties in exchange for cash, its initial basis in such properties for federal income tax purposes generally will be equal to the purchase price paid by our Operating Partnership. Our Operating Partnership generally plans to depreciate each depreciable property for federal income tax purposes under the alternative depreciation system of depreciation ("ADS"). Under ADS, the Operating Partnership generally will depreciate buildings and improvements over a 40-year recovery period using a straight-line method and a mid-month convention and will depreciate furnishings and equipment over a 12-year recovery period. Our Operating Partnership's initial basis in properties acquired in exchange for units in our Operating Partnership should be the same as the transferor's basis in such properties on the date of acquisition by our Operating Partnership. Although the law is not entirely clear, our Operating Partnership generally will depreciate such property for federal income tax purposes over the same remaining useful lives and under the same methods used by the transferors. Our Operating Partnership's tax depreciation deductions will be allocated among the partners in accordance with their respective interests in our Operating Partnership, except to the extent that our Operating Partnership is required under the federal income tax laws governing partnership allocations to use a method for allocating tax depreciation deductions attributable to contributed properties.

#### **Sale of a Partnership's Property**

Generally, any gain realized by a Partnership on the sale of property held by the Partnership for more than one year will be long-term capital gain, except for any portion of such gain that is treated as depreciation or cost recovery recapture. Any gain or loss recognized by a Partnership on the disposition of contributed properties will be allocated first to the partners of the Partnership who contributed such properties to the extent of their built-in gain or loss on those properties for federal income tax purposes. The partners' built-in gain or loss on such contributed properties will equal the difference between the partners' proportionate share of the book value of those properties and the partners' tax basis allocable to those properties at the time of the contribution. Any remaining gain or loss recognized by the Partnership on the disposition of the contributed properties, and any gain or loss recognized by the Partnership on the disposition of the other properties, will be allocated among the partners in accordance with their respective percentage interests in the Partnership.

Our share of any gain realized by a Partnership on the sale of any property held by the Partnership as inventory or other property held primarily for sale to customers in the ordinary course of the Partnership's trade or business will be treated as income from a prohibited transaction that is subject to a 100% penalty tax. Such prohibited transaction income also may have an adverse effect upon our ability to satisfy the income tests for REIT status. See "Federal Income Tax Consequences of our Status as a REIT — Income Tests." We, however, do not presently intend to acquire or hold or to allow any Partnership to acquire or hold any property that represents inventory or other property held primarily for sale to customers in the ordinary course of our or such Partnership's trade or business.

#### **Taxable REIT Subsidiaries**

We may own up to 100% of the stock of one or more TRSs. A TRS is a fully taxable corporation that may earn income that would not be qualifying income if earned directly by us. A TRS may provide services to our tenants and perform activities unrelated to our tenants, such as third-party management, development, and other independent business activities. However, a TRS may not directly or indirectly

operate or manage any hotels or health care facilities or provide rights to any brand name under which any hotel or health care facility is operated.

We and our corporate subsidiary must elect for the subsidiary to be treated as a TRS. A corporation of which a qualifying TRS directly or indirectly owns more than 35% of the voting power or value of the stock will automatically be treated as a TRS. Overall, no more than 20% of the value of our assets may consist of securities of one or more TRSs, and no more than 25% of the value of our assets may consist of the securities of TRSs and other assets that are not qualifying assets for purposes of the 75% asset test.

Rent that we receive from our TRSs will qualify as “rents from real property” as long as at least 90% of the leased space in the property is leased to persons other than TRSs and related party tenants, and the amount paid by the TRS to rent space at the property is substantially comparable to rents paid by other tenants of the property for comparable space. The TRS rules limit the deductibility of interest paid or accrued by a TRS to us if certain tests regarding the TRS’s debt-to-equity ratio and interest expense are satisfied. Further, the rules impose a 100% excise tax on transactions between a TRS and us or our tenants that are not conducted on an arm’s-length basis.

We believe that all transactions between us and any TRS that we form or acquire will be conducted on an arm’s-length basis.

#### **Recent and Proposed Changes in Federal Income Tax Laws**

Recently enacted legislation has reduced the rate of certain corporate dividends received by noncorporate taxpayers to 15%. Dividends we pay (other than capital gain dividends designated by us as 15% rate dividends) generally will not be eligible for this 15% rate unless such dividends are attributable to “qualified dividend income” we receive from corporations in which we invest or unless they are attributable to income on which we elect to pay corporate income tax. We do not expect a significant portion of our income to consist of qualified dividend income or income on which we elect to pay corporate income tax. It is possible that this legislation may cause certain investments to be more attractive to individual investors than an investment in our shares and could materially affect the value of our shares.

Proposed legislation would make certain technical corrections to the federal income tax rules applicable to REITs, including a modification of the definition of “straight debt” for purposes of the limitation on the value of securities of a single issuer a REIT may own, a new safe-harbor regarding the dates for testing whether 90% of a REIT’s property is rented to unrelated persons, elimination of one safe-harbor allowing rents received by a REIT to be exempt from the 100% excise tax if the rents are for customary services performed by a TRS or are from a TRS, elimination of the rule that substitutes 90% for 95% for purposes of determining the amount by which the 95% gross income test is failed, a provision allowing a REIT to pay a penalty and retain its status as a REIT in connection with qualification failures other than the source of income requirements. As of the date of this prospectus, we cannot predict whether the proposed legislation ultimately will be enacted into law, and if so, the form or effective date of that legislation.

#### **State and Local Taxes**

We and our stockholders may be subject to taxation by various states and localities, including those in which we or our stockholders transact business, own property or reside. The state and local tax treatment may differ from the federal income tax treatment described above. Consequently, stockholders should consult their own tax advisers regarding the effect of state and local tax laws upon an investment in the common shares.

#### **TRANSFER AND DIVIDEND PAYING AGENT AND REGISTRAR**

Our transfer and dividend paying agent and registrar for the shares of common stock being offered by this prospectus will be The Bank of New York. The principal business address of The Bank of New York is 100 Church Street, 14th Floor, New York, New York 10286.

## UNDERWRITING

Subject to the terms and conditions of an underwriting agreement dated \_\_\_\_\_, 2003, the underwriters named below have severally agreed to purchase from us the number of shares of common stock indicated in the following table. Ferris, Baker Watts, Incorporated is the representative of the underwriters.

Underwriters	Number of Shares
Ferris, Baker Watts, Incorporated	<u>4,420,000</u>

The underwriters propose to offer shares of our common stock directly to the public at the public offering price set forth on the cover page of this prospectus. Any shares sold by the underwriters to securities dealers will be sold at the public offering price less a selling concession not in excess of \$ \_\_\_\_\_ per share. The underwriters may allow, and these selected dealers may re-allow, a concession of not more than \$ \_\_\_\_\_ per share to other brokers and dealers.

The underwriters' obligations to purchase shares of our common stock are subject to conditions contained in the underwriting agreement. The underwriters are obligated to purchase all of the shares of common stock that they have agreed to purchase under the underwriting agreement, other than those covered by the over-allotment option, if they purchase any shares.

Other than in the United States, no action has been taken by us or by the underwriters that would permit a public offering of the shares of common stock included in this offering in any jurisdiction where action for that purpose is required. The shares of common stock included in this offering may not be offered or sold, directly or indirectly, nor may this prospectus or any other offering material or advertisements in connection with the offer and sales of any shares of common stock be distributed or published in any jurisdiction, except under circumstances that will result in compliance with the applicable rules and regulations of that jurisdiction. Persons who receive this prospectus are advised to inform themselves about and to observe any restrictions relating to this offering of shares of our common stock and the distribution of this prospectus. This prospectus is not an offer to sell nor a solicitation of any offer to buy any shares of our common stock included in this offering in any jurisdiction where that would not be permitted or legal.

The representatives of the underwriters have advised us that the underwriters do not intend to confirm sales to any account over which they exercise discretionary authority.

### Underwriting Discount and Expenses

The following table summarizes the underwriting discount to be paid to the underwriters by us.

	Per Share	Total without Over-allotment	Total with Over-allotment
Underwriting discount to be paid to the underwriters by us			

We will pay all expenses of the offering that we incur. We estimate that our total expenses of this offering, excluding the underwriting discount, will be approximately \$1 million.

### Over-allotment Option

We have granted to the underwriters an option, exercisable not later than 30 days after the date of this prospectus, to purchase up to 780,000 additional shares of our common stock at the public offering price, less the underwriting discount, set forth on the cover page of this prospectus. The underwriters may exercise the option solely to cover over-allotments, if any, made in connection with this offering. To the extent that the underwriters exercise the option, each underwriter will become obligated, as long as the conditions of the underwriting agreement are satisfied, to purchase a number of additional shares of

common stock approximately proportionate to that underwriter's initial commitment as indicated in the table above. We will be obligated, pursuant to the option, to sell these additional shares of common stock to the underwriters to the extent the option is exercised. If any additional shares of common stock are purchased pursuant to the option, the underwriters will offer the additional shares on the same terms as those on which the other shares are being offered hereby.

#### **Indemnification**

We have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act of 1933, or to contribute to payments the underwriters may be required to make in respect of any of these liabilities.

#### **Lockup Agreement**

Except with respect to our grant of options pursuant to the 2003 Equity Incentive Plan, we and each of our officers, directors and other stockholders have agreed not to offer, sell, contract to sell or otherwise dispose of, or enter into any transaction that is designed to, or could reasonably be expected to, result in the disposition of any shares of our common stock or other securities convertible into or exchangeable or exercisable for shares of our common stock for a period of 180 days after the date of this prospectus, other than shares of common stock issuable by us upon exercise of options, in exchange for properties or in connection with a dividend reinvestment plan, without the prior written consent of the representatives of the underwriters. This consent may be given at any time without public notice. With the exception of the underwriters' over-allotment option, there are no present agreements between the representatives of the underwriters and us or any of our executive officers, directors or stockholders releasing us or them from these lock-up agreements prior to the expiration of the 180-day period.

#### **Stabilization, Short Positions and Penalty Bids**

The underwriters may engage in over-allotment, syndicate covering transactions, stabilizing transactions and penalty bids or purchases for the purpose of pegging, fixing or maintaining the price of our common stock:

- Over-allotment involves sales by the underwriters of shares in excess of the number of shares the underwriters are obligated to purchase, which creates a syndicate short position. The short position may be either a covered short position or a naked short position. In a covered short position, the number of shares over-allotted by the underwriters is not greater than the number of shares that they may purchase in the over-allotment option. In a naked short position, the number of shares involved is greater than the number of shares in the over-allotment option. The underwriters may close out any short position by either exercising their over-allotment option, in whole or in part, or purchasing shares in the open market.
- Syndicate covering transactions involve purchases of our common stock in the open market after the distribution has been completed in order to cover syndicate short positions. In determining the source of shares to close out the short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. If the underwriters sell more shares than could be covered by the over-allotment option, resulting in a naked short position, the position can only be closed out by buying shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there could be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase in the offering.
- Stabilizing transactions consist of various bids for or purchases of common stock in the open market prior to completion of the offering.



- Penalty bids permit the representatives to reclaim a selling concession from a syndicate member when the common stock originally sold by the syndicate member is purchased in a stabilizing or syndicate covering transaction to cover syndicate short positions.

These syndicate covering transactions, stabilizing transactions and penalty bids may have the effect of raising or maintaining the market price of our common stock or preventing or retarding a decline in the market price of our common stock. As a result, the price of our common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the Nasdaq National Market or otherwise and, if commenced, may be discontinued at any time.

Neither we nor any of the underwriters make any representation or prediction as to the direction or magnitude of any effort that the transactions described above may have on the price of our common stock. In addition, neither we nor any of the underwriters make any representation that the underwriters will engage in these stabilizing transactions or that any transaction, once commenced, will not be discontinued without notice.

#### **Pricing of the Offering**

Prior to this offering, there has been no public market for our common stock. Consequently, the initial public offering price for our common stock has been determined by negotiations between us and the representatives of the underwriters. Among the primary factors considered in determining the initial public offering price were:

- prevailing market conditions;
- our capital structure;
- the present stage of our development;
- the valuation multiples of publicly traded companies that the representatives believe to be comparable to us; and
- estimates of our business potential and earning prospects.

#### **Directed Share Program**

At our request, the underwriters have reserved up to \_\_\_\_\_ shares, or \_\_\_\_\_ % of the common stock offered by this prospectus, for sale under a directed share program to specified officers, directors, business associates and other persons that we identify. All of the persons purchasing the reserved shares must commit to purchase no later than the close of business on the day following the date of this prospectus. The number of shares available for sale to the general public will be reduced to the extent these persons purchase the reserved shares. Shares committed to be purchased by directed share participants which are not so purchased will be reallocated for sale to the general public in the offering. All shares sold pursuant to the directed share program will be restricted from resale for a period of 180 days following the completion of this offering.

All sales of shares pursuant to the directed share program will be made at the initial public offering price set forth on the cover page of this prospectus less the underwriters discount. The underwriters will not receive any discounts or commission on the shares being sold pursuant to the directed share program. We will receive the same amount of cash per share from the sale of the shares pursuant to the directed share program as we will from the sale of shares to the general public. Accordingly, the investors in the offering will not experience any additional dilution by virtue of the directed share program.

#### **Electronic Distribution**

A prospectus in electronic format may be made available on Internet web sites or through other online services maintained by one or more of the underwriters or selling group members participating in this offering, or by their affiliates. In those cases, prospective investors may view offering terms online and,

depending upon the particular underwriter or selling group member, prospective investors may be allowed to place orders online. The underwriters may agree with us to allocate a specific number of shares for sale to online brokerage account holders. Any such allocation for online distributions will be made by the underwriters on the same basis as other allocations.

Other than the prospectus in electronic format, information contained in any other web site maintained by an underwriter or selling group member is not part of this prospectus or the registration statement of which this prospectus forms a part, has not been approved or endorsed by us and should not be relied on by investors in deciding whether to purchase any shares of our common stock. The underwriters and selling group members are not responsible for information contained in web sites that they do not maintain.

#### **EXPERTS**

The financial statements as of March 31, 2003 and for the period from February 14, 2003 (inception) through March 31, 2003 then ended included in this prospectus have been so included in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

#### **REPORTS TO STOCKHOLDERS**

We will furnish our stockholders with annual reports containing consolidated financial statements audited by our independent certified public accountants and we will make available to our stockholders quarterly reports containing unaudited financial data for the first three quarters of each fiscal year.

#### **LEGAL MATTERS**

The validity of the issuance of the common stock offered hereby will be passed upon for us by Cooley Godward LLP, Reston, Virginia. The validity of the shares of common stock offered hereby will be passed upon for the underwriters by Bass, Berry & Sims PLC, Memphis, Tennessee.

#### **WHERE YOU CAN FIND MORE INFORMATION**

We have filed with the SEC a registration statement on Form S-11, including exhibits and amendments filed with this registration statement, under the Securities Act of 1933 with respect to shares of our common stock to be sold in this offering. This prospectus does not contain all of the information set forth in the registration statement and exhibits to the registration statement. For further information with respect to our company and the shares of our common stock to be sold in this offering, reference is made to the registration statement, including the exhibits to the registration statement. Statements contained in this prospectus as to the contents of any contract or other document referred to in this prospectus are not necessarily complete and, where that contract is an exhibit to the registration statement, each statement is qualified in all respects by reference to the exhibit to which the reference relates. Copies of the registration statement, including the exhibits to the registration statement, may be examined without charge at the public reference room of the Securities and Exchange Commission, 450 Fifth Street, N.W. Room 1024, Washington, DC 20549. Information about the operation of the public reference room may be obtained by calling the Securities and Exchange Commission at 1-800-SEC-0300. Copies of all or a portion of the registration statement can be obtained from the public reference room of the Securities and Exchange Commission upon payment of prescribed fees. Our SEC filings, including our registration statement, are also available to you on the SEC's Web site at <http://www.sec.gov>.

As a result of this offering, we will become subject to the information and reporting requirements of the Securities Exchange Act of 1934, and we will file periodic reports, proxy statements and other information with the SEC. These periodic reports, proxy statements and other information will be available for inspection and copying at the SEC's public reference room and the SEC's Web site referred to above.

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## REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the accompanying balance sheet and the related statements of operations, stockholder's deficit and cash flows present fairly, in all material respects, the financial position of Gladstone Commercial Corporation (the "Company") at March 31, 2003, and the results of its operations and its cash flows for the period from February 14, 2003 (inception) to March 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

New York, New York

June 10, 2003

GLADSTONE COMMERCIAL CORPORATION

BALANCE SHEET

March 31, 2003

<b>ASSETS:</b>	
Cash and cash equivalents	\$ 10,000
Total assets	\$ 10,000
<b>LIABILITIES AND STOCKHOLDER'S DEFICIT</b>	
Liabilities	
Accounts payable	\$ 10,549
Stockholder's Deficit	
Common stock, \$0.001 par value, 20,000,000 shares authorized, 52,000 shares outstanding	52
Additional paid in capital	51,948
Stock subscription receivable	(42,000)
Retained deficit	(10,549)
Total stockholder's deficit	(549)
Total liabilities and stockholder's deficit	\$ 10,000

The accompanying notes are an integral part of these financial statements

GLADSTONE COMMERCIAL CORPORATION

STATEMENT OF OPERATIONS

For the Period February 14, 2003 (Inception) to March 31, 2003

REVENUES:	\$ —
EXPENSES:	
Organizational costs	5,549
General and administrative	5,000
Total expenses	10,549
Net loss	\$(10,549)
Basic and diluted loss per share	\$ (.20)
Weighted average shares outstanding	52,000

The accompanying notes are an integral part of these financial statements

GLADSTONE COMMERCIAL CORPORATION

STATEMENT OF STOCKHOLDER'S DEFICIT

For the Period February 14, 2003 (Inception) to March 31, 2003

	Common Stock	Additional Paid in Capital	Stock Subscription Receivable	Retained Deficit	Total
Issuance of common shares	\$ 52	\$51,948	\$ (42,000)	\$ —	\$ 10,000
Net loss				(10,549)	(10,549)
Balance, March 31, 2003	\$ 52	\$51,948	\$ (42,000)	\$(10,549)	\$ (549)

The accompanying notes are an integral part of these financial statements

GLADSTONE COMMERCIAL CORPORATION

STATEMENT OF CASH FLOWS

For the Period February 14, 2003 (Inception) to March 31, 2003

Cash flows from operating activities:	
Net loss	\$(10,549)
Increase in accounts payable	10,549
	<u>          </u>
Net cash used by operating activities	—
	<u>          </u>
Cash flows from investing activities:	
Proceeds from share issuance	10,000
	<u>          </u>
Net cash provided by financing activities	10,000
	<u>          </u>
Net increase in cash and cash equivalents	10,000
Cash and cash equivalents, beginning of period	—
	<u>          </u>
Cash and cash equivalents, end of period	\$ 10,000
	<u>          </u>

The accompanying notes are an integral part of these financial statements



## GLADSTONE COMMERCIAL CORPORATION

### NOTES TO FINANCIAL STATEMENTS

#### 1. Organization

Gladstone Commercial Corporation, a Maryland corporation (the "Company"), was formed on February 14, 2003 under the General Corporation Law of Maryland for the purpose of engaging in the business of investing in and owning property connected therewith net leased to creditworthy corporations and other creditworthy entities. Subject to certain restrictions and limitations, the business of the Company will be managed by Gladstone Management Corporation (the "Adviser").

On February 15, 2003, the sole stockholder purchased 52,000 shares of common stock (the "Shares") for \$52,000 and was admitted as the initial stockholder of the Company. At March 31, 2003, \$10,000 in cash has been received by the Company and the remainder has been reflected as a reduction in Stockholder's equity as a stock subscription receivable.

A minimum of 4,420,000 and a maximum of 5,200,000 Shares are being offered to the public (the "Offering") at a price of \$15 per share. The Company intends to invest the net proceeds of the Offering in properties, as described in the prospectus of the Company contained in a Registration Statement on Form S-11 filed with the Securities and Exchange Commission (the "Prospectus").

#### 2. Summary of Significant Accounting Policies

##### 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. Items classified as cash equivalents include commercial paper and money-market funds. All of the Company's cash and cash equivalents at March 31, 2003 were held in the custody of one financial institution, and which balance at times may exceed federally insurable limits. The Company mitigates this risk by depositing funds with major financial institutions.

##### Organizational costs

The Company expenses organizational costs (primarily filing fees and legal expenses) as incurred.

##### Income taxes

At the earliest date possible, the Company intends 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.

##### 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.

#### 3. Related Party Transactions

Pursuant to the advisory agreement, the Adviser will perform certain services for the Company including the identification, evaluation, negotiation, purchase and disposition of property, the day-to-day management of the Company and the performance of certain administrative duties.

**GLADSTONE COMMERCIAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**4. Subsequent Events**

On May 28, 2003, the Company completed the formation of a subsidiary, Gladstone Commercial Limited Partnership (the “Operating Partnership”). The Operating Partnership currently has no assets or operations, but the Company anticipates that it will conduct 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 will be consolidated with those of the Company.

As of June 10, 2003, the sole stockholder had contributed \$42,000 to the Company in satisfaction of the stockholder subscription receivable.

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No dealer, salesperson or other individual has been authorized to give any information or to make any representations other than those contained in this prospectus in connection with the offer made by this prospectus and, if given or made, such information or representations must not be relied upon as having been authorized by us or the underwriters. This prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities in any jurisdiction in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so, or to any person to whom it is unlawful to make such offer or solicitation. Neither the delivery of this prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in our affairs or that information contained herein is correct as of any time subsequent to the date hereof.

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Through and including 2003 (the 25th day after the date of this prospectus), all dealers effecting transactions in these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to a dealer's obligation to deliver a prospectus when acting as an underwriter with respect to an unsold allotment or subscription.

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**GLADSTONE**

**COMMERCIAL  
CORPORATION**

**4,420,000**

**Shares of Common Stock**

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PROSPECTUS

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**Ferris, Baker Watts**

Incorporated

June , 2003

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**PART II.**

**INFORMATION NOT REQUIRED IN PROSPECTUS**

**Item 31. Other Expenses of Issuance and Distribution.**

The following table sets forth the costs and expenses of the sale and distribution of the securities being registered, all of which are being borne by the Registrant.

Securities and Exchange Commission registration fee	\$6,310.20
NASD listing fee	*
Printing and engraving fees	*
Legal fees and expenses	*
Accounting fees and expenses	*
Blue sky fees and expenses	*
Transfer Agent and Registrar fees	*
Miscellaneous	*
Total	\$ *

\* To be filed by amendment.

**Item 32. Sales to Special Parties.**

On February 15, 2003, a total of 52,000 shares of common stock were sold to David Gladstone, the chairman of our board of directors and our chief executive officer, at a purchase price of \$1.00 per share.

**Item 33. Recent Sales of Unregistered Securities.**

On February 15, 2003, we issued and sold 52,000 shares of common stock for an aggregate purchase price of \$52,000 to Mr. Gladstone. We offered and sold these shares to Mr. Gladstone in reliance upon the exemption from registration provided by Section 4(2) under the Securities Act of 1933 and Rule 506 promulgated thereunder.

**Item 34. Indemnification of Directors and Officers.**

Our articles of incorporation provide that we will indemnify our directors and officers, whether in their capacity as directors or officers of us or, at our request, of another entity, to the full extent required or permitted by the laws of the State of Maryland currently in force and as they may be amended from time to time. In addition to indemnification of our directors and officers, we will also indemnify other employees and agents, including our advisers, to such extent as our bylaws permit or as otherwise authorized by our board of directors and permitted by Maryland law.

Our bylaws provide that any indemnification, or payment of expenses in advance of the final disposition of any proceeding, shall be made promptly, and in any event within 60 days, upon the written request of the director, officer, employee or other agent entitled to seek indemnification. This right to indemnification and advances is enforceable in any court of competent jurisdiction if we deny a request for indemnification in whole or in part or if the claim is not disposed of within 60 days. We will also reimburse the costs and expenses of an indemnitee incurred in connection with successfully establishing his or her right to indemnification in whole or in part.

We will have a defense to any claim for indemnification if (a) a determination has been made that the facts then known to those making the determination would preclude indemnification or (b) we have not received both (i) an undertaking, as required by law, by the claimant to repay such advances in the event it shall ultimately be determined that the standard of conduct necessary for indemnification by us has not been met, and (ii) a written affirmation by the claimant of his or her good faith belief that the

standard of conduct necessary for indemnification by us has been met. In addition, we will not be liable for any payment in connection with a claim made by any director, officer, employee or other agent to the extent such person has otherwise actually received payment under any insurance policy, agreement, vote or otherwise, of the amounts otherwise indemnifiable under our bylaws.

Our articles of incorporation provide that our board of directors may take such action as is necessary to carry out these indemnification provisions and is expressly empowered to adopt, approve, and amend from time to time the provisions of our bylaws, as well as resolutions or contracts implementing such provisions or such further indemnification arrangements as may be permitted by law. However, no amendment, repeal or other modification of our bylaws or our articles of incorporation may diminish the rights to indemnification of any person with respect to events occurring or claims made before its adoption or as to claims made after its adoption in respect of events occurring before its adoption.

The provisions of our articles of incorporation and our bylaws regarding indemnification and advance of expenses are not exclusive and do not supersede any other rights to which a person seeking indemnification or advance of expenses may be entitled under law or any agreement, vote of stockholders or disinterested directors, or other provision that is consistent with law.

Our articles of incorporation also provide that none of our directors or officers shall be liable to us or to our stockholders for money damages except (a) to the extent that it is proved that such director or officer actually received an improper benefit or profit in money, property or services actually received, or (b) to the extent that a judgment or other final adjudication adverse to such director or officer is entered in a proceeding based on a finding in the proceeding that such director's or officer's action, or failure to act, was (i) the result of active and deliberate dishonesty, or (ii) intentionally wrongful, willful or malicious and, in each such case, was material to the cause of action adjudicated in the proceeding.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 (the "Act") may be permitted to our directors, officers and controlling persons pursuant to the provisions described above, or otherwise, we have been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than our payment of expenses incurred or paid by a director, officer or controlling person in the successful defense of an action, suit or proceeding) is asserted by a director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of our counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of the court of the issue.

We intend to carry liability insurance for the benefit of its directors and officers on a claims-made basis of up to \$10,000,000, subject to a retention of up to \$200,000 for certain claims and the other terms thereof.

**Item 35.      *Treatment of Proceeds from Stock Being Registered.***

Not applicable.

**Item 36. Financial Statements and Exhibits.**

(a) *Financial Statements.*

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(b) *Exhibits.* The following exhibits are filed as part of this Registration Statement on Form S-11:

Exhibit	Description of Document
1.1*	Underwriting Agreement
3.1	Amended and Restated Articles of Incorporation of the Registrant
3.2	Bylaws of the Registrant
3.3*	Agreement of Limited Partnership of Gladstone Commercial Limited Partnership, dated , 2003.
5.1*	Opinion of Cooley Godward LLP, with respect to the legality of the shares being registered
8.1*	Opinion of Cooley Godward LLP with respect to tax matters
10.1	Advisory Agreement between Registrant and Gladstone Management Corporation, dated June 1, 2003
10.2	Equity Incentive Plan
23.1*	Consent of Cooley Godward LLP (included in its opinion filed as Exhibit 5.1 hereto)
23.2*	Consent of Cooley Godward LLP (included in its opinion filed as Exhibit 8.1 hereto)
23.3	Consent of PricewaterhouseCoopers LLP (independent auditors of the Registrant)
23.4	Consent of David A.R. Dullum
23.5	Consent of Michela A. English
23.6	Consent of Anthony W. Parker
23.7	Consent of Paul W. Adelgren
24.1	Power of attorney (included in the signature page to this registration statement)

\* To be filed by amendment.

**Item 37. Undertakings.**

The undersigned Registrant hereby undertakes as follows:

(1) To provide to the underwriters at the closing specified in the Underwriting Agreement certificates in such denominations and registered in such names as required by the underwriters to permit prompt delivery to each purchaser.

(2) Insofar as indemnification by the registrant for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the registrant pursuant to the provisions referenced in Item 34 of this Registration Statement or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act, and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer, or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered hereunder, the registrant will, unless in the opinion of

its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

(3) For purposes of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this Registration Statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) under the Securities Act shall be deemed to be part of this Registration Statement as of the time it was declared effective.

(4) For the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering.

**SIGNATURES AND POWERS OF ATTORNEY**

Pursuant to the requirements of the Securities Act of 1933, as amended, the undersigned registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-11 and has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the County of Fairfax, Commonwealth of Virginia, on the \_\_\_\_\_ day of June, 2003.

GLADSTONE COMMERCIAL CORPORATION

By: \_\_\_\_\_ /s/ DAVID J. GLADSTONE

David J. Gladstone  
*Chairman of the Board of Directors and Chief Executive Officer*

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints David J. Gladstone and Terry Lee Brubaker, his or her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this registration statement, and any additional related registration statement filed pursuant to Rule 462(b) under the Securities Act of 1933, as amended (including post-effective amendments to the registration statement and any such related registration statements), and to file the same, with all exhibits thereto, and any other documents in connection therewith, granting unto said attorneys-in-fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, as amended, this registration statement has been signed below by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
_____ /s/ DAVID J. GLADSTONE David J. Gladstone	Chairman of the Board of Directors and Chief Executive Officer (Principal Executive Officer)	June , 2003
_____ /s/ TERRY LEE BRUBAKER Terry Lee Brubaker	President, Secretary, Chief Operating Officer and Director	June , 2003
_____ /s/ HARRY BRILL Harry Brill	Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)	June , 2003



## Exhibit Index

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\* To be filed by amendment.

ARTICLES OF AMENDMENT AND RESTATEMENT

TO

ARTICLES OF INCORPORATION

OF

GLADSTONE COMMERCIAL CORPORATION

Gladstone Commercial Corporation, a Maryland corporation (the "CORPORATION"), having its principal office at c/o The Corporation Trust Incorporated, 300 East Lombard Street, Baltimore City, Maryland, hereby certifies to the State Department of Assessments and Taxation that:

ONE: The Corporation desires to amend and restate the Charter of the Corporation.

TWO: These Articles of Amendment and Restatement of the Corporation were duly adopted by the Board of Directors of the Corporation and approved by the stockholders of the Corporation.

THREE: The amendment and restatement of the Charter of the Corporation does not increase nor decrease the authorized capital stock of the Corporation.

FOUR: The Charter of the Corporation is hereby amended and restated in its entirety to read as follows:

FIRST: The name of the Corporation is Gladstone Commercial Corporation (which is hereafter called the "CORPORATION").

SECOND : The purpose for which the Corporation is formed is to engage in any lawful business and activity, including, without limitation, but subject to any contrary requirements necessary to qualify the Corporation as a real estate investment trust (a "REIT") under Part II of Subchapter M of the Internal Revenue Code of 1986, as amended (and any successor provisions and as those rules may be modified for purposes of REITs) (collectively, the "CODE"):

1. To purchase, acquire, hold, own, improve, develop, sell, convey, assign, release, finance, refinance, mortgage, encumber, use, lease, hire, manage, deal in and otherwise dispose of real property and personal property of every kind and nature or any interest therein, improved or otherwise, including without limitation mortgage loans, promissory notes, collateralized certificates, stocks and securities of other corporations or entities; to lend money; to take real estate, securities and other collateral as security for the payment of all sums due the Corporation; and to sell, assign and release such securities;

2. To equip, furnish, improve, develop and manage any property, real or personal; to invest, trade and deal in any property, real or personal; to encumber or dispose of any such property at any time held or owned by the Corporation; and

3. To have and exercise any and all powers and privileges now or hereafter conferred by the general laws of the State of Maryland upon corporations formed under such laws.

The foregoing enumeration of the purposes of the Corporation is made in furtherance and not in limitation of the powers conferred upon the Corporation by law. The mention of any particular purpose is not intended in any manner to limit or restrict the generality of any other purpose mentioned, or to limit or restrict any of the powers of the Corporation. The Corporation shall have, enjoy and exercise all of the powers and rights now or hereafter conferred by the laws of the State of Maryland upon corporations of a similar character, it being the intention that the purposes set forth in each of the paragraphs of this Article shall, except as otherwise expressly provided, in nowise be limited or restricted by reference to or inference from the terms of any other clause or paragraph of this or any other Article of these Articles of Incorporation, or of any amendment thereto, and shall each be regarded as independent and construed as powers as well as purposes; provided, however, that nothing herein contained shall be deemed to authorize or permit the Corporation to carry on any business or exercise any power, or do any act, which a corporation formed under the general laws of the State of Maryland may not at the time lawfully carry on or do.

THIRD: The post office address of the principal office of the Corporation in this State is c/o The Corporation Trust Incorporated, 300 East Lombard Street, Baltimore, Maryland 21202. The name of the Resident Agent of the Corporation in this State is The Corporation Trust Incorporated whose address is 300 East Lombard Street, Baltimore, Maryland 21202.

FOURTH: The total number of shares of capital stock which the

Corporation has authority to issue is twenty million (20,000,000) shares of common stock, with a par value of \$0.001 per share.

FIFTH: The number of directors of the Corporation shall be three (3), subject to change in accordance with the Bylaws of the Corporation. The current directors are: David Gladstone and Terry L. Brubaker. The third seat on the board of directors is currently vacant, to be filled in accordance with the Bylaws of the Corporation.

SIXTH: Except as may otherwise be provided by the Board of Directors, no holder of any shares of the stock of the Corporation shall have any pre-emptive right to purchase, subscribe for, or otherwise acquire any shares of stock of the Corporation of any class now or hereafter authorized, or any securities exchangeable for or convertible into such shares, or any warrants or other instruments evidencing rights or options to subscribe for, purchase or otherwise acquire such shares. The shares have no cumulative voting rights and, except as provided in Article EIGHTH below, are not subject to redemption.

SEVENTH: The following provisions are hereby adopted for the purpose of defining, limiting and regulating the powers of the Corporation and of the directors and stockholders:

1. The Board of Directors of the Corporation is hereby empowered to authorize the issuance from time to time of shares of its stock of any class or classes, whether now or hereafter authorized.

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2. The Board of Directors of the Corporation may classify or reclassify any unissued stock by setting or changing in any one or more respects, from time to time before issuance of such stock, the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications and terms and conditions of redemption of such stock. A majority of the entire Board of Directors, without action by the stockholders, may amend the Charter to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class that the Corporation has authority to issue.

3. The Corporation reserves the right to amend its Charter so that such amendment may alter the contract rights, as expressly set forth in the charter, of any outstanding stock, and any objecting stockholder whose rights may or shall be thereby substantially adversely affected shall not be entitled to demand and receive payment of the face value of his stock.

The enumeration and definition of a particular power of the Board of Directors included in the foregoing shall in no way be limited or restricted by reference to or inference from the terms of any other cause of this or any other article of the Charter of the Corporation, or construed as or deemed by inference or otherwise in any manner to exclude or limit any powers conferred upon the Board of Directors under the Maryland General Corporation Law now or hereafter in force.

4. The Corporation shall indemnify (1) its directors and officers, whether serving the Corporation or at its request any other entity, to the full extent required or permitted by the General Laws of the State of Maryland now or hereafter in force, including the advance of expenses under the procedures and to the full extent permitted by law, and (2) other employees and agents (including Corporation's advisers) to such extent as shall be authorized by the Board of Directors or the Corporation's Bylaws and be permitted by law. The foregoing rights of indemnification shall not be exclusive of any other rights to which those seeking indemnification may be entitled. The Board of Directors may take such action as is necessary to carry out these indemnification provisions and is expressly empowered to adopt, approve, and amend from time to time such Bylaws, resolutions, or contracts implementing such provisions or such further indemnification arrangements as may be permitted by law. No amendment of the Charter or repeal of any of its provisions shall limit or eliminate the right to indemnification provided hereunder with respect to acts or omissions occurring prior to such amendment or repeal.

5. No director or officer of the Corporation shall be liable to the Corporation or to its stockholders for money damages except (1) to the extent that it is proved that such director or officer actually received an improper benefit or profit in money, property or services actually received, or (2) to the extent that a judgment or other final adjudication adverse to such director or officer is entered in a proceeding based on a finding in the proceeding that such director's or officer's action, or failure to act, was (a) the result of active and deliberate dishonesty, or (b) intentionally wrongful, willful or malicious and, in each such case, was material to the cause of action adjudicated in the proceeding.

6. Notwithstanding any provision of law to the contrary, the affirmative vote of a majority of all the votes entitled to be cast on the matter shall be sufficient, valid and effective, after due authorization,

approval or advice of such action by the Board of Directors, as required by law, to approve and authorize the following acts of the Corporation:

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(a) The amendment of the Charter of the Corporation;

(b) the consolidation of the Corporation with one or more corporations to form a new consolidated corporation;

(c) the merger of the Corporation into another corporation or the merger of one or more other corporations into the Corporation;

(d) the sale, lease, exchange or other transfer of all, or substantially all, of the property and assets of the Corporation, including its goodwill and franchises;

(e) the participation by the Corporation in a share exchange (as defined in the Corporation and Associations Article of the Annotated Code of Maryland) as the corporation the stock of which is to be acquired; and

(f) the voluntary or involuntary liquidation, dissolution or winding-up of the Corporation.

EIGHTH: The following provisions are hereby adopted for the purpose of restricting the transfer and acquisition of shares, and providing a redemption right:

1. Whenever it is deemed by the Board of Directors to be prudent in protecting the tax status of the Corporation as a REIT, the Board of Directors may require to be filed with the Corporation a statement or affidavit from each proposed transferee of shares of capital stock of the Corporation setting forth the number of such shares already owned, or deemed to be owned under rules of constructive ownership, by the transferee and any other person(s) specified in the form prescribed by the Board of Directors for that purpose and such other information as the Board of Directors deems relevant for this purpose. Any contract for the sale or other transfer of shares of capital stock of the Corporation shall be subject to this provision.

2. Prior to any transfer or transaction which would cause a person to own, directly, indirectly or constructively, shares in excess of the Limit (as defined in Section 4 of this Article EIGHTH), and in any event upon demand of the Board of Directors or its designee, such stockholder shall file with the Corporation an affidavit setting forth the number of shares of capital stock of the Corporation (i) owned directly and (ii) owned indirectly (for purposes of this Section, shares of capital stock not owned directly shall be deemed to be owned indirectly by a person if that person would be the beneficial owner of such shares for purposes of Rule 13d-3, or any successor rule thereto, promulgated under the Securities Exchange Act of 1934, as amended (the "EXCHANGE ACT"), or would be considered to own such shares by reason of the attribution rules in Section 544 of the Code or the regulations issued thereunder or any successor provision and as those rules may be modified for purposes of the REIT provisions of the Code) by the person filing the affidavit. Such affidavit shall contain such additional information as deemed relevant by the Board of Directors for purposes of carrying out its duties hereunder. The affidavit to be filed with the Corporation shall set forth all information required to be disclosed by stockholders under Treasury Regulation Section 1.857-9 issued under the Code or similar provisions of any successor regulation, and in reports to be filed under Section 13(d) of the Exchange Act. The affidavit, or an amendment thereto, shall be filed with the Corporation within ten (10) days after

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demand therefor and at least fifteen (15) days prior to any transfer or transaction which, if consummated, would cause the filing person to hold a number of shares of capital stock of the Corporation in excess of the Limit (as defined in Section 4 of this Article EIGHTH below). The Board of Directors or its designee shall have the right, but shall not be required, to refuse to transfer any shares of capital stock of the Corporation purportedly transferred other than in compliance with the provisions of this Section.

3. Any acquisition of shares of capital stock of the Corporation that would result in the disqualification of the Corporation as a REIT under the Code shall be void ab initio to the fullest extent permitted under applicable law and the intended transferee of such shares shall be deemed never to have had an interest therein. If the foregoing provision is determined to be void or invalid by virtue of any legal decision, statute, rule or regulation, then the transferee of such shares shall be deemed, at the option of the Corporation, to have acted as agent on behalf of the Corporation in acquiring such Excess Shares (as defined below) and to hold such Excess Shares on behalf of the ultimate owner of such Excess Shares. Any person who receives dividends, interest or any

other distribution paid on account of Excess Shares shall hold and retain these dividends, interest or any other distribution as an agent for the Corporation.

While the Excess Shares are so held on behalf of the ultimate owner of such Excess Shares, such Excess Shares shall not have any voting rights and shall not be considered for purposes of any stockholder vote or determining a quorum for such a vote. The Excess Shares shall not be treasury stock but shall continue as issued and outstanding Shares under the General Corporation Law of Maryland.

Upon discovering the ownership of any Excess Shares, the Board of Directors may (i) cause the Corporation to immediately redeem such Excess Shares pursuant to Section 6 of this Article EIGHTH or (ii) grant the stockholder thirty (30) days to transfer such Excess Shares to any person or group whose ownership of such Excess Shares would not result in a violation of this Article EIGHTH. Upon such permitted transfer, the Corporation shall pay or distribute to the transferee any dividends on the Excess Shares not previously paid or distributed. If such Excess Shares are not transferred within such thirty (30)-day period, the Corporation will be deemed to have redeemed such Excess Shares pursuant to Section 6 of this Article EIGHTH.

4. Notwithstanding any other provision hereof to the contrary and subject to the provisions of Section 5 of this Article EIGHTH, no person or persons acting as a group shall at any time own (directly or under constructive ownership rules relevant for purposes of qualifying the Corporation as a REIT) in the aggregate more than nine and eight-tenths percent (9.8%) of the outstanding shares of capital stock of the Corporation (the "LIMIT"). Shares which but for this Article EIGHTH would be owned by a person or persons acting as a group and would, at any time, be in excess of the Limit shall be deemed Excess Shares. For the purpose of determining ownership of Excess Shares, "OWNERSHIP" of shares shall be deemed to include shares constructively owned by a person under the provisions Sections 542, 544 and 856 of the Code (and any successor provision and as those rules may be modified for purposes of the REIT provisions of the Code) and also shall include shares beneficially owned under the provisions of Rule 13d-3 promulgated under the Exchange Act. For purposes of determining persons acting as a group, "GROUP" shall have the same meaning as such term has for purposes of Section 13(d)(3) of the Exchange Act. All shares of capital stock of the Corporation which any person or persons

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acting as a group have the right to acquire upon exercise of outstanding rights, options and warrants, and upon conversion of any securities convertible into such shares, if any, shall be considered outstanding for purposes of determining the applicable Limit if such inclusion will cause such person or persons acting as a group to own more than the Limit. The Board of Directors shall have the right, but shall not be required, to refuse to transfer shares of capital stock of the Corporation if, as a result of the proposed transfer, any person or persons acting as a group would hold or be deemed to hold Excess Shares.

5. The Limit set forth in Section 4 of this Article EIGHTH shall not apply to the acquisition of shares of capital stock of the Corporation: (i) by an underwriter in a public offering of such shares; (ii) pursuant to a cash tender offer made for all outstanding shares (including securities convertible into common stock, which subsequently may be issued by the Corporation) in conformity with applicable federal and state securities laws where at least ninety percent (90%) of the outstanding shares (not including shares or subsequently issued securities convertible into common stock, which are held by the tender offeror or any "affiliates" or "associates" thereof within the meaning of the Exchange Act) are duly tendered and accepted pursuant to the cash tender offer; or (iii) in any transaction involving the issuance of shares of capital stock by the Corporation in which the Board of Directors determines that the underwriter or other person or party initially acquiring such shares will timely distribute such shares to or among others such that, following such distribution, none of such shares will be deemed to be Excess Shares. The Board of Directors in its discretion may exempt from the Limit and from the filing requirements of Section 2 of this Article EIGHTH ownership or transfers of certain designated shares of capital stock of the Corporation while owned by or transferred to a person who has provided the Board of Directors with evidence and assurances acceptable to the Board of Directors that the qualification of the Corporation as a REIT under the Code and the regulations issued under the Code would not be jeopardized thereby.

6. At the discretion of the Board of Directors, all Excess Shares may be redeemed by the Corporation. Written notice of redemption shall be provided to the holder of the Excess Shares not less than one week prior to the redemption date (the "REDEMPTION DATE") determined by the Board of Directors and included in the notice of redemption. The redemption price to be paid for Excess Shares shall be equal to the lesser of the price paid for the Excess Shares by the stockholder in whose possession the redeemed shares were formerly Excess Shares or the Fair Market Value of the Excess Shares. "Fair Market Value" shall mean (i) the closing price of such shares on the principal national securities exchange on which such shares are listed or admitted to trading on the last

business day prior to the Redemption Date, or (ii) if such shares are not so listed or admitted to trading, the closing bid price on such last business day as reported on the NASDAQ System, if quoted thereon, or (iii) if the redemption price is not determinable in accordance with clause (i) or (ii) of this sentence, the fair market value of such shares determined in good faith by the Board of Directors. The redemption price for any shares of capital stock of the Corporation so redeemed shall be paid on the Redemption Date. From and after the Redemption Date, the holder of any shares of capital stock of the Corporation called for redemption shall cease to be entitled to any distributions and other benefits with respect to such shares, except the right to payment of the redemption price fixed as aforesaid.

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7. Nothing contained in this Article EIGHTH or in any other provision hereof shall limit the authority of the Board of Directors to take such other action as it in its sole discretion deems necessary or advisable to protect the Corporation and the interests of its stockholders by maintaining the Corporation's eligibility to be, and preserving the Corporation's status as, a qualified REIT under the Code.

8. For purposes of this Article EIGHTH only, the term "PERSON" shall include individuals (including natural persons and organizations treated as natural persons in Section 542(a) of the Code), corporations, limited partnerships, general partnerships, joint stock companies or associations, joint ventures, associations, consortia, companies, trusts, banks, trust companies, land trusts, common law trusts, business trusts, unincorporated associations or other entities and governments and agencies and political subdivisions thereof.

9. If any provision of this Article EIGHTH or any application of any such provision is determined to be invalid by any federal or state court having jurisdiction over the issue, the validity of the remaining provisions shall not be affected and other applications of such provision shall be affected only to the extent necessary to comply with the determination of such court. To the extent any provision of this Article EIGHTH may be inconsistent with any other provisions of these articles of incorporation, this Article EIGHTH shall be controlling.

10. In the event that a stockholder knowingly holds Excess Shares and the Corporation consequently loses its status as a REIT under the Code or becomes a personal holding company, such stockholder shall be required to indemnify the Corporation for the full amount of any damages and expenses (including, without limitation, increased corporate taxes, attorneys' fees and administrative costs) resulting from the Corporation's loss of its REIT qualification under the Code.

11. Nothing herein contained shall limit the ability of the Corporation to impose or seek judicial or other imposition of additional restrictions if deemed necessary or advisable to protect the Corporation and the interests of its stockholders by preservation of the Corporation's status as a REIT.

12. All persons or groups who own five percent (5%) or more of the Corporation's outstanding shares during any taxable year of the Corporation shall file with the Corporation an affidavit setting forth the number of shares during such taxable year (a) owned directly (held of record by such person or group, or by a nominee or nominees of such person or group), and (b) owned indirectly (by reason of Section 542, 544 or 856 of the Code or for purposes of Section 13(d) of the Exchange Act) by the person or group filing the affidavit. The affidavit to be filed with the Corporation shall set forth all the information required to be reported (i) in returns of stockholders under Treasury Regulation Section 1.857-9 issued under the Code or similar provisions of any successor regulation, and (ii) in reports to be filed under Section 13(d) of the Exchange Act. The affidavit or amendment to a previously-filed affidavit shall be filed with the Corporation annually within 60 days after the close of the Corporation's taxable year. A person or group shall have satisfied the requirements of this Section 12 of this Article EIGHTH if the person or group furnishes to the Corporation the information in such person or group's possession after such person or group has made a good faith effort to determine the shares it

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indirectly owns and to acquire the information required by Treasury Regulation Section 1.857-9 issued under the Code or similar provisions of any successor regulation.

TENTH: The duration of the Corporation shall be perpetual.

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IN WITNESS WHEREOF, I, David Gladstone, Chief Executive Officer of Gladstone Commercial Corporation, hereby acknowledge on behalf of Gladstone Commercial Corporation that the foregoing Articles of Amendment and Restatement are the corporate act of the Corporation under the penalties of perjury this \_\_\_ day of \_\_\_\_\_, 2003.

-----  
David Gladstone, Chief Executive Officer

WITNESS:

- -----  
Terry L. Brubaker, Secretary

BYLAWS  
OF  
GLADSTONE COMMERCIAL CORPORATION  
(A MARYLAND CORPORATION)

ARTICLE I  
OFFICES

SECTION 1. PRINCIPAL OFFICE. The principal office shall be in the City of Baltimore, State of Maryland.

SECTION 2. ADDITIONAL OFFICES. The Corporation may also have offices at such other places both within and without the State of Maryland as the Board of Directors may from time to time determine or the business of the Corporation may require.

ARTICLE II  
MEETINGS OF STOCKHOLDERS

SECTION 3. PLACE. Unless the Articles of Incorporation provide otherwise, meetings of stockholders shall be held at the office of the Corporation in the Commonwealth of Virginia, or at any other place within the United States as shall be designated from time to time by the Board of Directors and stated in the notice of meeting or in a duly executed waiver of notice thereof.

SECTION 4. ANNUAL MEETING.

(A) The annual meeting of the stockholders of the Corporation, for the purpose of election of directors and for such other business as may lawfully come before it, shall be held on such date and at such time as may be designated from time to time by the Board of Directors. Nominations of persons for election to the Board of Directors and the proposal of business to be considered by the stockholders may be made at an annual meeting of stockholders: (i) pursuant to the Corporation's notice of meeting of stockholders; or (ii) by or at the direction of the Board of Directors; or (iii) by any stockholder of the Corporation who is a stockholder of record at the time of giving of notice provided for in the following paragraph, who is entitled to vote at such meeting and who complied with the notice procedures set forth in this Section 4.

(B) At an annual meeting of the stockholders, only such business shall be conducted as shall have been properly brought before the meeting. For nominations or other business to be properly brought before an annual meeting by a stockholder pursuant to clause (iii) of Section 4(a) of these Bylaws, (i) the stockholder must have given timely notice thereof in writing to the Secretary of the Corporation, (ii) such other business must be a proper matter for stockholder action under law, (iii) if the stockholder, or the beneficial owner on whose behalf any such proposal or nomination is made, has provided the Corporation with a Solicitation Notice (as defined in this Section 4(b)), such stockholder or beneficial owner must, in the case of a proposal, have delivered a proxy statement and form of proxy to holders of at least the percentage of the Corporation's voting shares required under applicable law to carry any such proposal, or, in the case of a nomination or nominations, have delivered a proxy statement and form of proxy to holders of a percentage of the Corporation's voting shares reasonably believed by such stockholder or beneficial owner to be sufficient to elect the nominee or nominees proposed to be nominated by such stockholder, and must, in either case, have included in such materials the Solicitation Notice, and (iv) if no Solicitation Notice relating thereto has been timely provided pursuant to this section, the stockholder or beneficial owner proposing such business or nomination must not have solicited a number of proxies sufficient to have required the delivery of such a Solicitation Notice under this Section 4. To be timely, a stockholder's notice shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the close of business on the sixtieth (60th) day nor earlier than the close of business on the ninetieth (90th) day prior to the first anniversary of the preceding year's annual meeting; provided, however, that in the event that the date of the annual meeting is advanced more than thirty (30) days prior to or delayed by more than thirty (30) days after the anniversary of the preceding year's annual meeting, notice by the stockholder to be timely must be so delivered not earlier than the close of business on the ninetieth (90th) day prior to such annual meeting and not later than the close of business on the later of the sixtieth (60th) day prior to such annual meeting or the tenth (10th) day following the day on which public announcement of the date of such meeting is first made. In no event shall the public announcement of an adjournment of an annual meeting commence a new time period for the giving of a stockholder's notice as described above. Such stockholder's notice shall set forth: (A) as to each person whom the stockholder proposed to nominate for



election or reelection as a director all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "1934 Act") and Rule 14a-11 thereunder (including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected); (B) as to any other business that the stockholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any material interest in such business of such stockholder and the beneficial owner, if any, on whose behalf the proposal is made; and (C) as to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (i) the name and address of such stockholder, as they appear on the Corporation's books, and of such beneficial owner, (ii) the class and number of shares of the Corporation which are owned beneficially and of record by such stockholder and such beneficial owner, and (iii) whether either such stockholder or beneficial owner intends to deliver a proxy statement and form of proxy to holders of, in the case of the proposal, at least the percentage of the Corporation's voting shares required under applicable law to carry the proposal or, in the case of a nomination or nominations, a sufficient number of holders of the Corporation's voting shares to elect such nominee or nominees (an affirmative statement of such intent, a "Solicitation Notice").

(C) Notwithstanding anything in the second sentence of Section 4(b) of these Bylaws to the contrary, in the event that the number of directors to be elected to the Board of

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Directors of the Corporation is increased and there is no public announcement naming all of the nominees for director or specifying the size of the increased Board of Directors made by the Corporation at least seventy (70) days prior to the first anniversary of the preceding year's annual meeting, a stockholder's notice required by this Section 4 shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the close of business on the tenth (10th) day following the day on which such public announcement is first made by the Corporation.

(D) Only such persons who are nominated in accordance with the procedures set forth in this Section 4 shall be eligible to serve as directors and only such business shall be conducted at a meeting of stockholders as shall have been brought before the meeting in accordance with the procedures set forth in this Section 4. Except as otherwise provided by law, the Chairman of the meeting shall have the power and duty to determine whether a nomination or any business proposed to be brought before the meeting was made, or proposed, as the case may be, in accordance with the procedures set forth in these Bylaws and, if any proposed nomination or business is not in compliance with these Bylaws, to declare that such defective proposal or nomination shall not be presented for stockholder action at the meeting and shall be disregarded.

(E) Notwithstanding the foregoing provisions of this Section 4, in order to include information with respect to a stockholder proposal in the proxy statement and form of proxy for a stockholders' meeting, stockholders must provide notice as required by the regulations promulgated under the 1934 Act. Nothing in these Bylaws shall be deemed to affect any rights of stockholders to request inclusion of proposals in the Corporation proxy statement pursuant to Rule 14a-8 under the 1934 Act.

(F) For purposes of this Section 4, "public announcement" shall mean disclosure in a press release reported by the Dow Jones News Service, Associated Press or comparable national news service or in a document publicly filed by the Corporation with the Securities and Exchange Commission pursuant to Section 13, 14 or 15(d) of the 1934 Act.

## SECTION 5. SPECIAL MEETINGS.

(A) Special meetings of the stockholders of the corporation may be called, for any purpose or purposes, by (i) the Chairman of the Board of Directors, (ii) the Chief Executive Officer, (iii) President, (iv) the Board of Directors pursuant to a resolution adopted by a majority of the total number of authorized directors (whether or not there exist any vacancies in previously authorized directorships at the time any such resolution is presented to the Board of Directors for adoption), (v) a majority of the independent directors, or (vi) stockholders of the Corporation who are stockholders of record at the time of giving of notice and who hold at least the percentage of the voting securities of the Corporation required by Section 3-805 of the Maryland General Corporation Law.

(B) If a special meeting is properly called by any person or persons other than the Board of Directors, the request shall be in writing, specifying the general nature of the business proposed to be transacted, and shall be delivered personally or sent by certified or registered mail, return receipt

requested, to the Chairman of the Board of Directors, the Chief

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Executive Officer, the President or the Secretary of the Corporation. No business may be transacted at such special meeting otherwise than specified in such notice. The Board of Directors shall determine the time and place of such special meeting, which shall be held not less than thirty-five (35) nor more than one hundred twenty (120) days after the date of the receipt of the request. Upon determination of the time and place of the meeting, the officer receiving the request shall cause notice to be given to the stockholders entitled to vote, in accordance with the provisions of Section 6 of these Bylaws. Nothing contained in this paragraph (b) shall be construed as limiting, fixing, or affecting the time when a meeting of stockholders called by action of the Board of Directors may be held.

(C) Nominations of persons for election to the Board of Directors may be made at a special meeting of stockholders at which directors are to be elected pursuant to the Corporation's notice of meeting (i) by or at the direction of the Board of Directors or (ii) by any stockholder of the Corporation who is a stockholder of record at the time of giving notice provided for in these Bylaws who shall be entitled to vote at the meeting and who complies with the notice procedures set forth in this Section 5(c). In the event the Corporation calls a special meeting of stockholders for the purpose of electing one or more directors to the Board of Directors, any such stockholder may nominate a person or persons (as the case may be), for election to such position(s) as specified in the Corporation's notice of meeting, if the stockholder's notice required by Section 4(b) of these Bylaws shall be delivered to the Secretary at the principal executive offices of the Corporation not earlier than the close of business on the ninetieth (90th) day prior to such special meeting and not later than the close of business on the later of the sixtieth (60th) day prior to such meeting or the tenth (10th) day following the day on which public announcement is first made of the date of the special meeting and of the nominees proposed by the Board of Directors to be elected at such meeting. In no event shall the public announcement of an adjournment of a special meeting commence a new time period for the giving of a stockholder's notice as described above.

SECTION 6. NOTICE. Except as otherwise provided herein or by law, notice, given in writing or by electronic transmission, of each meeting of stockholders shall be given not less than ten (10) nor more than ninety (90) days before the date of the meeting to each stockholder entitled to vote at such meeting, such notice to specify the place, if any, date and hour, in the case of special meetings, the purpose or purposes of the meeting, and the means of remote communications, if any, by which stockholders and proxy holders may be deemed to be present in person and vote at any such meeting. If mailed, notice is given when deposited in the United States mail, postage prepaid, directed to the stockholder at such stockholder's address as it appears on the records of the Corporation. Notice of the time, place, if any, and purpose of any meeting of stockholders may be waived in writing, signed by the person entitled to notice thereof, or by electronic transmission by such person, either before or after such meeting, and will be waived by any stockholder by his attendance thereat in person, by remote communication, if applicable, or by proxy, except when the stockholder attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Any stockholder so waiving notice of such meeting shall be bound by the proceedings of any such meeting in all respects as if due notice thereof had been given.

SECTION 7. PRESIDING OFFICER; STATEMENT OF AFFAIRS; ORDER OF BUSINESS.

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(A) Meetings of stockholders shall be presided over by the Chairman of the Board of Directors, if any, or, if he is not present (or, if there is none), by the Chief Executive Officer, or, if he is not present, by the President, or, if he is not present, by a Vice President, or, if none are present, by such person as may have been chosen by the Board of Directors, or if none of such persons is present, by a chairman to be chosen by the stockholders owning a majority of the shares of capital stock of the Corporation issued and outstanding and entitled to vote at the meeting and who are present in person or represented by proxy. The Secretary of the Corporation, or, if he is not present, the Assistant Secretary, or, if he is not present, such person as may be chosen by the Board of Directors, or if none of such persons is present, then such person as may be chosen by the stockholders owning a majority of the shares of capital stock of the Corporation issued and outstanding and entitled to vote at the meeting and who are present in person or represented by proxy shall act as secretary of the meeting.

(B) The following order of business, unless otherwise ordered at the meeting, shall be observed as far as practicable and consistent with the purposes of the meeting:

- (1) Call of the meeting to order.

(2) Presentation of proof of mailing of the notice of the meeting and, if the meeting is a special meeting, the call thereof.

(3) Presentation of proxies.

(4) Announcement that a quorum is present.

(5) Reading and approval of the minutes of the previous meeting.

(6) Reports, if any, of officers.

(7) Submission of statement of affairs by the Chief Financial Officer or Treasurer, if the meeting is an annual meeting.

(8) Election of directors, if the meeting is an annual meeting or a meeting called for that purpose.

(9) Miscellaneous business.

(10) Adjournment.

SECTION 8. QUORUM; ADJOURNMENTS. At any meeting of stockholders the presence in person or by proxy of stockholders entitled to cast a majority of all the votes entitled to be cast at the meeting shall constitute a quorum; but this section shall not affect any requirement under law or under the Articles of Incorporation for the vote necessary for the adoption of any measure. If, however, such quorum shall not be present or represented at any meeting of the stockholders, the stockholders entitled to vote thereat, present in person or represented by proxy, shall have power to adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present or represented. At such adjourned meeting at which a

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quorum shall be present or represented, any business may be transacted which might have been transacted at the meeting as originally notified.

#### SECTION 9. VOTING.

(A) A majority of the votes cast at a meeting of stockholders, duly called and at which a quorum is present, shall be sufficient to take or authorize action upon any matter which may properly come before the meeting, unless more than a majority of the votes cast is required by law, these Bylaws or by the Articles of Incorporation.

(B) If two or more classes of stock are entitled to vote separately on any matter for which the law requires approval by two-thirds of all the votes entitled to be cast, the matter shall be approved by two-thirds of all the votes of each class, unless these Bylaws or the Articles of Incorporation provide otherwise. Notwithstanding the foregoing, a plurality of all the votes cast at a meeting at which a quorum is present is sufficient to elect a director.

(C) Unless the Articles of Incorporation provide otherwise, each outstanding share of stock having voting power, regardless of class, shall be entitled to one vote on each matter submitted to a vote at a meeting of stockholders; but no share shall be entitled to vote if any installment payable on it is overdue and unpaid. A stockholder may vote the shares owned of record by such stockholder either in person or by proxy executed in writing by the stockholder or by such stockholder's duly authorized attorney-in-fact. No proxy shall be valid after eleven months from its date, unless otherwise provided in the proxy. At all meetings of stockholders, unless the voting is conducted by inspectors, all questions relating to the qualification of voters and the validity of proxies and the acceptance or rejection of votes shall be decided by the chairman of the meeting.

(D) At all elections of directors of the Corporation each stockholder having voting power shall not be entitled to exercise the right of cumulative voting.

#### SECTION 10. ACTION WITHOUT MEETING.

(A) Any action required or permitted to be taken at any meeting of stockholders may be taken without a meeting, if a unanimous written consent which sets forth the action is signed by each stockholder entitled to vote on the matter is filed with the records of the of stockholders' meetings.

(B) Unless the Articles of Incorporation requires otherwise, the holders of any class of stock other than common stock, entitled to vote generally in the election of directors, may take action or consent to any action by the written consent of the stockholders entitled to cast not less than the minimum number of votes that would be necessary to authorize or take the action at a stockholders' meeting if the Corporation gives notice of the action to each stockholder not later than ten (10) days after the effective time of the action.

(C) Notwithstanding the foregoing, no such action by written consent may be taken following the closing of the initial public offering pursuant to an effective registration statement under the Securities Act of 1933, as amended (the "1933 Act"), covering the offer and sale of Common Stock of the Corporation to the public (the "Initial Public Offering").

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SECTION 11. TELEPHONE MEETINGS. Stockholders may participate in a meeting by means of a conference call or similar communications equipment by means of which all persons participating can hear each other at the same time, and participation in the meeting by such means shall conclusively be deemed to constitute presence in person at such meeting.

### ARTICLE III

#### DIRECTORS

SECTION 12. POWERS. The business and affairs of the Corporation shall be managed by its Board of Directors, which may exercise all of the powers of the Corporation, except such as are by law or by the Articles of Incorporation or by these Bylaws conferred upon or reserved to the stockholders. Each director, including each independent director, may engage in other business activities of the type conducted by the Corporation and are not required to present to the Corporation any investment opportunities presented to them even though the investment opportunities may be within the Corporation's investment policies.

#### SECTION 13. NUMBER AND TERM.

(A) The number of directors of the Corporation shall initially be three (3) until increased or decreased pursuant to the following provisions, but shall never be greater than nine (9) or fewer than one (1). Following the closing of the Initial Public Offering, the composition of the board of directors must satisfy the independence standards of the Nasdaq Stock Market (or such other securities market on which the Corporation's securities are listed for trading) and the applicable rules and regulations of the Securities and Exchange Commission ("SEC"). A majority of the entire Board of Directors may, at any time and from time to time, increase or decrease the number of directors of the Corporation as set forth in the Articles of Incorporation or these Bylaws; provided, however, that the number of directors shall not be increased by fifty percent (50%) or more in any twelve (12) month period without the approval of two-thirds (2/3rds) of the members of the Board of Directors then in office. The tenure of office of a director shall not be affected by any decrease in the number of directors so made by the Board of Directors. The directors shall be elected by a majority of all the votes cast at the annual meeting of the stockholders, except as provided in Section 15 of these Bylaws.

(B) Following the closing of the Initial Public Offering, the Corporation shall be subject to the provisions set forth in Title 3, Subtitle 8 of the Maryland General Corporation Law. Subject to the rights of the holders of any series of Preferred Stock to elect additional directors under specified circumstances, following the closing of the Initial Public Offering, the directors shall be divided into three classes to be designated Class I, Class II and Class III, respectively. The initial Class I directors shall hold office for a term expiring at the annual meeting of the stockholders held in the first year following the closing of the Initial Public Offering. The initial Class II directors shall hold office for a term expiring at the annual meeting of the stockholders held in the second year following the closing of the Initial Public Offering. The initial Class III directors shall hold office for a term expiring at the annual meeting of the stockholders held in the third year following the closing of the Initial Public Offering.

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(C) At each annual meeting of the stockholders commencing with the first annual meeting after the closing of the Initial Public Offering, the successor or successors of the class of directors whose term expires at that meeting (other than directors elected by the holders of any series of Preferred Stock) shall hold office for a term expiring at the annual meeting of the stockholders held in the third year following the year of their election. The directors elected to each class (other than directors elected by any series of Preferred Stock) shall hold office until their successors are duly elected and qualify or until their earlier resignation or removal. Directors need not be stockholders.

#### SECTION 14. MATTERS FOR WHICH ACTION OF THE ENTIRE BOARD IS REQUIRED.

Notwithstanding anything to the contrary in these Bylaws, the following actions shall require the approval by the affirmative vote of a majority of the entire Board of Directors:

(A) appointing any director to a committee of the Board of Directors pursuant to Article IV of these Bylaws;

(B) appointing any employee, officer, or director of the Corporation, or any person who is to become an employee, officer, or director of the Corporation, to serve as an officer above the level of principal; and

(C) altering, amending or repealing these Bylaws or adopting new bylaws.

SECTION 15. VACANCY. Any vacancy occurring in the Board of Directors for any reason, including by reason of an increase in the number of directors, may be filled by a majority of the remaining members of the Board of Directors, although such majority is less than a quorum. Notwithstanding the foregoing, if the stockholders of any class or series are entitled separately to elect one or more directors, a majority of the remaining directors elected by that class or series or the sole remaining director elected by that class or series may fill any vacancy among the number of directors elected by that class or series. A director elected by the Board of Directors to fill a vacancy shall be elected to hold office for the remainder of the full term of the class of directors in which the vacancy occurred and until his successor is elected and qualifies.

#### SECTION 16. REMOVAL AND RESIGNATION.

(A) Subject to the rights of any series of Preferred Stock to elect or to remove additional directors under specified circumstances, unless otherwise provided by law or the Articles of Incorporation, at any meeting of stockholders, duly called and at which a quorum is present, the stockholders may, by the affirmative vote of the holders of sixty-six and two-thirds percent (66 2/3%) of the votes generally entitled to be cast thereon, remove any director or directors from office for cause. The stockholders may not remove a director without cause.

(B) Any director may resign at any time by giving written notice to the Board of Directors, the Chairman of the Board of Directors, the Chief Executive Officer, the President or the Secretary of the Corporation. Unless otherwise specified in the written notice, the resignation shall take effect upon delivery thereof to the Board of Directors or designated officer. It shall not be necessary for a resignation to be accepted before it becomes effective.

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SECTION 17. PLACE OF MEETINGS. Meetings of the Board of Directors, regular or special, may be held at any place within or without of the State of Maryland as the Board of Directors may from time to time determine.

SECTION 18. ANNUAL MEETING. The annual meeting of the Board of Directors shall be held immediately following the annual stockholders meeting, and no notice of such meeting shall be necessary to the directors in order legally to constitute the meeting, provided a quorum shall be present.

SECTION 19. REGULAR MEETINGS. Regular meetings of the Board of Directors may be held without notice at such time and place as shall from time to time be determined by the Board of Directors.

SECTION 20. SPECIAL MEETINGS. Special meetings of the Board of Directors may be called at any time by the Board of Directors or the Executive Committee, if one be constituted, by vote at a meeting, or by the Chairman of the Board of Directors, the Chief Executive Officer, the President or by a majority of the directors or a majority of the members of the Executive Committee in writing with or without a meeting. Special meetings may be held at such place or places within or without Maryland as may be designated from time to time by the Board of Directors; in the absence of such designation such meetings shall be held at such places as may be designated in the notice of the meeting.

SECTION 21. NOTICE. Notice of the place and time of every special meeting of the Board of Directors shall be served on each director or sent to him by mail, or by leaving the same at his residence or usual place of business or by telecopy, facsimile transmission, electronic mail or any other electronic means at least twenty-four (24) hours before the date of the meeting. A waiver of notice in writing, signed by a director entitled to such notice and filed with the records of the meeting, whether before or after the holding thereof, or actual attendance at the meeting, shall be deemed equivalent to the giving of such notice to such director.

SECTION 22. QUORUM; ADJOURNMENTS. At all meetings of the Board of Directors, a majority of the entire Board of Directors shall constitute a quorum for the transaction of business and the action of a majority of the directors present at any meeting at which a quorum is present shall be the action of the Board of Directors unless the concurrence of a greater proportion is required for such action by statute, the Articles of Incorporation or these Bylaws. If a quorum shall not be present at any meeting of directors, the directors present thereat may by a majority vote adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

SECTION 23. TELEPHONE MEETINGS. Members of the Board of Directors or any

committee thereof may participate in a meeting by means of a conference call or similar communications equipment by means of which all directors participating can hear each other at the same time, and participation in the meeting by such means shall conclusively be deemed to constitute presence in person at such meeting.

SECTION 24. ACTION WITHOUT MEETING. Any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a

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meeting, if a written consent to such action is signed by all members of the Board of Directors or of such committee, as the case may be, and such written consent is filed with the minutes of proceedings of the Board of Directors or committee.

SECTION 25. COMPENSATION OF DIRECTORS. Directors, as such, shall not receive any stated salary for their services but, by resolution of the Board of Directors, non-employee directors may be entitled to receive (a) an annual fee, (b) a fixed cash sum, (c) a stock or stock option grant, or (d) a combination of the above, along with the reimbursement of expenses of attendance, if any, for attendance at each regular or special meeting of the Board of Directors, or of any committee thereof, but nothing herein contained shall be construed to preclude any director from serving the Corporation in any other capacity and receiving compensation therefor.

SECTION 26. ADDITIONAL DUTIES OF THE DIRECTORS. Subject to the provisions of the Articles of Incorporation, the Board of Directors may from time to time adopt, amend, revise, or terminate any policy or policies with respect to investments by the Corporation as they shall deem appropriate in their sole discretion.

SECTION 27. DELEGATION OF AUTHORITY. Subject to the responsibility of the Board of Directors to supervise the management of the Corporation, the Board of Directors may assign administrative power, and may delegate to the Adviser (as defined in Section 59 of these Bylaws) certain responsibilities with respect to the making of investments on behalf of the Corporation.

#### ARTICLE IV

#### COMMITTEES.

SECTION 28. EXECUTIVE COMMITTEE. The Board of Directors may appoint an Executive Committee consisting of not fewer than three members, one of whom shall be the Chairman of the Board of Directors, and one of whom shall be designated as Chairman of the Executive Committee. Following the closing of the Initial Public Offering, the composition of the Executive Committee shall be consistent with the independence requirements for the full Board of Directors as defined by the listing standards of the Nasdaq Stock Market (or such other securities market on which the Corporation's securities are then listed for trading) and applicable SEC rules and regulations. The Executive Committee shall have and may exercise those rights, powers and authority of the Board of Directors as may from time to time be granted to it by the Board of Directors subject to any limitations imposed by law and may authorize the seal of the Corporation to be affixed to all papers which may require the same.

SECTION 29. ETHICS, NOMINATING AND CORPORATE GOVERNANCE COMMITTEE. The Board of Directors shall appoint an Ethics, Nominating and Corporate Governance Committee consisting of not fewer than two members, one of whom shall be designated as Chairman of the Ethics, Nominating and Corporate Governance Committee. Following the closing of the Initial Public Offering, each of the members of the Ethics, Nominating and Corporate Governance Committee shall be independent as defined by the listing standards of the Nasdaq Stock Market and applicable SEC rules and regulations. The Ethics, Nominating and Corporate Governance Committee shall have and may exercise those rights, powers and authority of the Board of Directors as may from time to time be granted

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to it by the Board of Directors; provided, however, that in addition to any such rights, powers or authority, the Ethics, Nominating and Corporate Governance Committee shall have the exclusive right to (1) recommend candidates for election as directors to the Board of Directors, and (2) administer the Corporation's code of ethics.

SECTION 30. COMPENSATION COMMITTEE. The Board of Directors may appoint from its membership a Compensation Committee consisting of not fewer than two members, one of whom shall be designated as Chairman of the Compensation Committee. Following the closing of the Initial Public Offering, each of the members of the Compensation Committee shall be independent as defined by the listing standards of the Nasdaq Stock Market (or such other securities market on which the Corporation's securities are then listed for trading) and applicable SEC rules and regulations. The Compensation Committee shall (1) determine the compensation of the executive officers of the Corporation, (2) negotiate the

advisory agreement with the Corporation's Adviser, and (3) administer the Corporation's equity incentive plans. The Compensation Committee shall also have and may exercise those rights, powers and authority of the Board of Directors as may from time to time be granted to it by the Board of Directors.

SECTION 31. AUDIT COMMITTEE. The Board of Directors may appoint from its membership an Audit Committee consisting of not fewer than three members, each of whom shall be independent directors within the meaning of Section 10A (m) of the 1934 Act, or any successor provision, applicable listing standards of the Nasdaq Stock Market (or such other securities market on which the Corporation's securities are then listed for trading) and applicable SEC rules and regulations. Each member of the Audit Committee shall also be free from any relationship that, in the opinion of the Board of Directors, would interfere with his or her exercise of independent judgment as a committee member. One member shall be designated as Chairman of the Audit Committee. All members of the Audit Committee shall have a working familiarity with basic finance and accounting practices, and at least one member of the Audit Committee shall have accounting or related financial management expertise. The Board of Directors shall adopt a formal written charter for the Audit Committee that specifies, among other things, the following: (1) the scope of the Audit Committee's responsibilities and the means by which the Audit Committee carries out these responsibilities; (2) the outside auditor's accountability to the Board of Directors and the Audit Committee and the Audit Committee's ultimate authority to select, evaluate and, where appropriate, replace the outside auditor; and (3) the Audit Committee's responsibility to oversee the independence of the outside auditor through the receipt of a formal written statement delineating all relationships between the auditor and the Corporation and active dialogue with the auditors.

SECTION 32. OTHER COMMITTEES. The Board of Directors, by resolutions adopted by a majority of the entire Board of Directors, may appoint such other committee or committees, as it shall deem advisable and impose upon such committee or committees such functions and duties, and grant such rights, powers and authority, as the Board of Directors shall prescribe (except the power to declare dividends or distributions on stock, to issue stock except to the extent permitted by law, to recommend to stockholders any action requiring stockholders' approval, to amend these Bylaws or to approve any merger or share exchange which does not require stockholders' approval).

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SECTION 33. PROCEDURE; NOTICE; MEETINGS. Each committee shall fix its own rules of procedure and shall meet at such times and at such place or places as may be provided by such rules or as the members of such committee shall provide. Committee meetings may be called by the Chairman of the Board of Directors, the Chief Executive Officer, the President, the chairman of the committee, if any, or any two or more committee members on at least twenty-four (24) hours notice, if such notice is mailed, delivered personally or sent by messenger, telecopy, facsimile transmission, electronic mail or any other electronic means. A waiver of notice in writing, signed by the committee member entitled to such notice and filed with the records of the meeting whether before or after the holding thereof, or actual attendance at the committee meeting, shall be deemed equivalent to the giving of such notice to such committee member. Each committee shall keep regular minutes of its meetings and deliver such minutes to the Board of Directors. The chairman of each committee, or, in his or her absence, a member of such committee chosen by a majority of the members of such committee present, shall preside at the meetings of such committee, and another member thereof, or any other person, chosen by such committee shall act as secretary of such committee, or in the capacity of secretary for purposes of such meeting.

SECTION 34. QUORUM; VOTE. With respect to each committee, a majority of its members shall constitute a quorum for the transaction of business, and the affirmative vote of a majority of the members thereof shall be required for any action of such committee.

SECTION 35. APPOINTMENTS; VACANCIES; CHANGES; DISCHARGES. The Board of Directors shall have the exclusive power at any time, through the approval by the affirmative vote of a majority of the entire Board of Directors, to appoint directors to, fill vacancies in, change the membership of, or discharge any committee.

SECTION 36. TENURE. Each member of a committee shall continue as a member thereof until the expiration of his or her term as a director, or his or her earlier resignation as a member of such committee or as a director, unless sooner removed as a member of such committee by a vote of a majority of the entire Board of Directors or as a director in accordance with these Bylaws.

SECTION 37. COMPENSATION. Members of any committee shall be entitled to such compensation for their services as members of any such committee and to such reimbursement for any reasonable expenses incurred in attending committee meetings as may from time to time be fixed by the Board of Directors. The compensation (if any) of members of any committee may be on such basis as is determined by the Board of Directors. Any member may waive compensation for any meeting. Any committee member receiving compensation under these provisions

shall not be barred from serving the Corporation in any other capacity and from receiving compensation and reimbursement of reasonable expenses for such other services.

SECTION 38. ACTION BY CONSENT. Any action required or permitted to be taken at any meeting of any committee of the Board of Directors may be taken without a meeting if a written consent to such action is signed by all members of the committee and such written consent is filed with the minutes of its proceedings.

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SECTION 39. MEETINGS BY TELEPHONE OR SIMILAR COMMUNICATIONS. The members of any committee which is designated by the Board of Directors may participate in a meeting of such committee by means of a conference telephone or similar communications equipment by means of which all members participating in the meeting can hear each other at the same time, and participation by such means shall be conclusively deemed to constitute presence in person at such meeting.

#### ARTICLE V

#### OFFICERS

SECTION 40. DESIGNATIONS. The officers of the Corporation shall be chosen by the Board of Directors and shall be a Chief Executive Officer, a President, a Secretary, a Chief Financial Officer and a Treasurer. The Board of Directors may also choose a Chairman of the Board of Directors, a Chief Operating Officer, a Chief Investment Officer, one or more Vice Presidents, one or more Principals, one or more Assistant Secretaries and Assistant Treasurers and any other officers deemed necessary or appropriate by the Board of Directors. Two or more offices, except those of President and Vice President, may be held by the same person but no officer shall execute, acknowledge or verify any instrument in more than one capacity, if such instrument is required by law, the Articles of Incorporation or these Bylaws to be executed, acknowledged or verified by two or more officers.

SECTION 41. TERM OF OFFICE; REMOVAL; RESIGNATION. At its annual meeting, the Board of Directors shall elect a Chief Executive Officer, a President, a Secretary, a Chief Financial Officer and a Treasurer. The Board of Directors may appoint such other officers and agents as it shall deem necessary, who shall hold their offices for such terms and shall exercise such powers and perform such duties as shall be determined from time to time by the Board of Directors. The officers of the Corporation shall serve for one year and until their successors are chosen and qualify. Any officer or agent may be removed by the Board of Directors whenever, in its judgment, the best interests of the Corporation will be served thereby, but such removal shall be without prejudice to the contractual rights, if any, of the person so removed. If the office of any officer becomes vacant for any reason, the vacancy shall be filled by the Board of Directors. Any officer may resign at any time by giving notice in writing or by electronic transmission to the Board of Directors, the Chief Executive Officer, the President or the Secretary. Any such resignation shall be effective when received by the person or persons such notice is given, unless a later time is specified therein, in which event the resignation shall become effective at such later time. Unless otherwise specified in such notice, the acceptance of any such resignation shall not be necessary to make it effective. Any resignation shall be without prejudice to the rights if any, of the Corporation under any contract with the resigning officer.

SECTION 42. COMPENSATION. The salaries of all officers and agents of the Corporation shall be fixed by the Board of Directors.

SECTION 43. CHAIRMAN OF THE BOARD OF DIRECTORS. The Chairman of the Board of Directors, when present, shall preside at all meetings of the stockholders and the Board of Directors. The Chairman of the Board of Directors shall perform other duties commonly

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incident to the office and shall also perform such other duties and have such other powers, as the Board of Directors shall designate from time to time. Unless otherwise determined by the Board of Directors, the Chairman shall also serve as the Chief Executive Officer and have the powers and duties set forth in Section 44.

SECTION 44. THE CHIEF EXECUTIVE OFFICER. The Chief Executive Officer shall be the chief executive officer of the Corporation and shall perform all duties incident to the office of Chief Executive Officer and such other duties as from time to time may be assigned to him by the Board of Directors. He shall be involved in the general management of the business of the Corporation, and shall see that all orders and resolutions of the Board of Directors are carried into effect. He shall have authority over the operations of the Corporation and its divisions, if any, subject only to the ultimate authority of the Board of Directors. He shall execute in the corporate name all authorized deeds, mortgages, bonds, contracts or other instruments requiring a seal, under the



seal of the Corporation, except in cases in which the signing or execution thereof shall be expressly delegated by the Board of Directors to some other officer or agent of the Corporation.

SECTION 45. THE PRESIDENT. The President shall be primarily responsible for the implementation of policies of the Board of Directors. In addition, in the absence or disability of the Chief Executive Officer, the President shall maintain the duties of the Chief Executive Officer. He shall have authority over the operations of the Corporation and its divisions, if any, subject only to the ultimate authority of the Chief Executive Officer and the Board of Directors. He may sign and execute in the name of the Corporation certificates, deeds, mortgages, bonds, contracts or other instruments except in cases where the signing and the execution thereof shall be expressly delegated by the Board of Directors or by these Bylaws to some other officer or agent of the Corporation or shall be required by law otherwise to be signed or executed. In addition, he shall perform all duties incident to the office of the President and such other duties as from time to time may be assigned to him by the Board of Directors.

SECTION 46. THE CHIEF OPERATING OFFICER. The Chief Operating Officer, if any, under the direction of the President, shall have general management authority and responsibility for the day-to-day implementation of the policies of the Corporation. In the absence or disability of the Chief Executive Officer and President, the Chief Operating Officer shall perform the duties and exercise the powers of the Chief Executive Officer and President, and shall perform such other duties and have such other powers as the Board of Directors may from time to time prescribe. He may sign and execute in the name of the Corporation certificates, deeds, mortgages, bonds, contracts or other instruments except in cases where the signing and the execution thereof shall be expressly delegated by the Board of Directors or by these Bylaws to some other officer or agent of the Corporation or shall be required by law otherwise to be signed or executed. In addition, he shall perform all duties incident to the office of Chief Operating Officer and such other duties as from time to time may be assigned to him by the Board of Directors.

SECTION 47. THE CHIEF INVESTMENT OFFICER. The Chief Investment Officer, if any, under the direction of the President, shall implement investment activities consistent with the policies of the Corporation. In the absence or disability of the Chief Executive Officer, President and Chief Operating Officer, the Chief Investment Officer shall perform the duties and exercise the powers of the Chief Executive Officer, President and Chief Operating Officer, and shall

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perform such other duties and have such other powers as the Board of Directors may from time to time prescribe.

SECTION 48. VICE PRESIDENTS AND PRINCIPALS. The Vice President or Principal, if any, or if there shall be more than one, the Vice Presidents and Principals, in the order determined by the Board of Directors, shall, in the absence or disability of the Chief Executive Officer, President, Chief Operating Officer, and Chief Investment Officer, perform the duties and exercise the powers of the Chief Executive Officer, President, Chief Operating Officer, and Chief Investment Officer, and shall perform such other duties and have such other powers as the Board of Directors may from time to time prescribe.

SECTION 49. THE SECRETARY AND ASSISTANT SECRETARIES.

(A) The Secretary shall attend all meetings of the Board of Directors and all meetings of the stockholders and record all the proceedings of the meetings of the Corporation and of the Board of Directors in a book to be kept for that purpose and shall perform like duties for the standing committees when required. He shall give, or cause to be given, notice of all meetings of the stockholders and special meetings of the Board of Directors, and shall perform such other duties as may be prescribed by the Board of Directors, the Chief Executive Officer or President, under whose supervision he shall be. He shall keep in safe custody the seal of the Corporation and, when authorized by the Board of Directors, affix the same to any instrument requiring it and, when so affixed, it shall be attested by his signature or by the signature of an Assistant Secretary.

(B) The Assistant Secretary, if any, or if there be more than one, the Assistant Secretaries in the order determined by the Board of Directors, shall, in the absence or disability of the Secretary, perform the duties and exercise the powers of the Secretary and shall perform such other duties and have such other powers as the Board of Directors may from time to time prescribe.

SECTION 50. THE CHIEF FINANCIAL OFFICER, TREASURER AND ASSISTANT TREASURERS.

(A) The Chief Financial Officer and the Treasurer shall have the custody of the corporate funds and securities and shall keep full and accurate accounts of receipts and disbursements in books belonging to the Corporation and shall deposit all moneys and other valuable effects in the name and to the credit of the Corporation in such depositories as may be designated by the Board

of Directors. The Chief Financial Officer and Treasurer may be the same person.

(B) The Chief Financial Officer or the Treasurer shall disburse the funds of the Corporation as may be ordered by the Board of Directors, taking proper vouchers for such disbursements, and shall render to the Chief Executive Officer, the President and the Board of Directors, at its regular meetings, or when the Board of Directors so requires an account of transactions and of the financial condition of the Corporation.

(C) If required by the Board of Directors, the Chief Financial Officer or the Treasurer shall give the Corporation a bond in such sum and with such surety or sureties as shall be satisfactory to the Board of Directors for the faithful performance of the duties of his office

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and for the restoration to the Corporation, in case of his death, resignation, retirement or removal from office, of all books, papers, vouchers, money and other property of whatever kind in his possession or under his control belonging to the Corporation.

(D) The Assistant Treasurer, if any, or if there shall be more than one, the Assistant Treasurers in the order determined by the Board of Directors, shall, in the absence or disability of the Treasurer, perform the duties and exercise the powers of the Treasurer and shall perform such other duties and have such other powers as the Board of Directors may from time to time prescribe.

#### ARTICLE VI

##### INDEMNIFICATION OF DIRECTORS, OFFICERS, EMPLOYEES, AGENTS AND ADVISERS

SECTION 51. PROCEDURE. Any indemnification, or payment of expenses in advance of the final disposition of any proceeding, shall be made promptly, and in any event within 60 days, upon the written request of the director, officer, employee or other agent entitled to seek indemnification (the "INDEMNIFIED PARTY"). The right to indemnification and advances hereunder shall be enforceable by the Indemnified Party in any court of competent jurisdiction, if (i) the Corporation denies such request, in whole or in part, or (ii) no disposition thereof is made within 60 days. The Indemnified Party's costs and expenses incurred in connection with successfully establishing his or her right to indemnification, in whole or in part, in any such action shall also be reimbursed by the Corporation. It shall be a defense to any action for advance for expenses that (a) a determination has been made that the facts then known to those making the determination would preclude indemnification or (b) the Corporation has not received both (i) an undertaking as required by law to repay such advances in the event it shall ultimately be determined that the standard of conduct has not been met and (ii) a written affirmation by the Indemnified Party of such Indemnified Party's good faith belief that the standard of conduct necessary for indemnification by the Corporation has been met.

SECTION 52. EXCLUSIVITY, ETC. The indemnification and advance of expenses provided by the Articles of Incorporation and these Bylaws shall not be deemed exclusive of any other rights to which a person seeking indemnification or advance of expenses may be entitled under law (common or statutory), or any agreement, vote of stockholders or disinterested directors, or other provision that is consistent with law, both as to action in his or her official capacity and as to action in another capacity while holding office or while employed by or acting as agent for the Corporation, shall continue in respect of all events occurring while a person was a director, officer, employee or other agent after such person has ceased to be a director, officer, employee or other agent, and shall inure to the benefit of the estate, heirs, executors, and administrators of such person. The Corporation shall not be liable for any payment under this Bylaw in connection with a claim made by any director, officer, employee or other agent to the extent such person has otherwise actually received payment under insurance policy, agreement, vote or otherwise, of the amounts otherwise indemnifiable hereunder. All rights to indemnification and advance of expenses under the Articles of Incorporation of the Corporation and hereunder shall be deemed to be a contract between the Corporation and each Indemnified Party who serves or served in the capacity of director, officer, employee or other agent at any time while this Bylaw

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is in effect. Nothing herein shall prevent the amendment of this Bylaw, provided that no such amendment shall diminish the rights of any person hereunder with respect to events occurring or claims made before its adoption or as to claims made after its adoption in respect of events occurring before its adoption. Any repeal or modification of this Bylaw shall not in any way diminish any rights to indemnification or advance of expenses of such Indemnified Party or the obligations of the Corporation arising hereunder with respect to events occurring, or claims made, while this Bylaw or any provision hereof is in force.

#### ARTICLE VII

## CERTIFICATES OF STOCK

### SECTION 53. FORM OF SIGNATURES; STATEMENTS.

(A) Except as provided in Section 53(b), shares of the Corporation's capital stock shall be issued without certificates. At the time of issuance or transfer of such uncertificated shares, the Corporation shall send the stockholder a written statement identifying: (1) the Corporation as the issuer of the stock; (2) the name of the stockholder or other person to whom it is issued; and (3) the class of stock and the number of shares represented by such statement. If the Corporation has authority at the time of such issuance or transfer to issue stock of more than one class, the written statement shall also include a full statement or summary of: (1) the designations and any preferences, conversion and other rights, voting powers, restrictions, limitations as to dividends, qualifications, and terms and conditions of redemption of the stock of each class which the Corporation is authorized to issue; and (2) if the Corporation is authorized at the time of such issuance or transfer to issue any preferred or special class in series, (i) the differences in the relative rights and preferences between the shares of each series to the extent they have been set, and (ii) the authority of the Board of Directors to set the relative rights and preferences of subsequent series. Notwithstanding the immediately preceding sentence, the written statement may, in lieu of including the information referred to therein, state that the Corporation will furnish a full statement of such information to any stockholder on request and without charge. If the Corporation imposes a restriction on transferability of such uncertificated shares, the written statement shall also: (1) contain a full statement of the restriction; or (2) state that the Corporation will furnish information about the restriction to the stockholder on request and without charge.

(B) Notwithstanding Section 53(a), every stockholder in the Corporation shall, upon request duly made to the Corporation or any transfer agent of the Corporation, be entitled to have a certificate, signed by the President, a Vice President or Chairman of the Board of Directors and countersigned by the Secretary, Assistant Secretary, Treasurer or Assistant Treasurer or other such officers as provided in Section 2-212 of the Maryland General Corporation Law, exhibiting the number and class (and series, if any) of shares owned by him, her or it, and bearing the seal of the Corporation. Such signatures and seal may be facsimile transmission. In case any officer who has signed, or whose facsimile signature was placed on, a certificate shall have ceased to be such officer before such certificate is issued, it may nevertheless be issued by the Corporation with the same effect as if he or she were such officer at the date of its issue.

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(C) Every certificate representing stock issued by the Corporation, if it is authorized to issue stock of more than one class, shall set forth upon the face or back of the certificate, a full statement or summary of the designations and any preferences, conversion and other rights, voting powers, restrictions, limitations as to dividends, qualifications, and terms and conditions of redemptions of the stock of each class which the Corporation is authorized to issue and, if the Corporation is authorized to issue any preferred or special class of stock in series, the differences in the relative rights and preferences between the shares of each series to the extent they have been set and the authority of the Board of Directors to set the relative rights and preferences of subsequent series. In lieu of such full statement or summary, there may be set forth upon the face or back of each certificate a statement that the Corporation will furnish to the stockholder, upon request and without charge, a full statement of such information.

SECTION 54. REGISTRATION OF TRANSFER. Upon surrender to the Corporation or any transfer agent of the Corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, or upon presentation to the Corporation or any transfer agent of the Corporation of an instruction with a request to register transfer of uncertificated shares, it shall be the duty of the Corporation or its transfer agent, if it is satisfied that all terms and conditions of the Articles of Incorporation, of the Bylaws and of applicable law regarding the transfer of shares have been fulfilled, to record the transaction upon its books, to issue a new certificate to the person entitled thereto upon request for such certificate, and to cancel the old certificate, if any.

### SECTION 55. REGISTERED STOCKHOLDERS.

(A) Except as otherwise provided by law, the Corporation shall be entitled to recognize the exclusive right of a person who is registered on its books as the owner of shares of its capital stock to receive dividends or other distributions, to vote as such owner, and to hold liable for calls and assessments a person who is registered on its books as the owner of shares of its capital stock. The Corporation shall not be bound to recognize any equitable or legal claim to or interest in such shares on the part of any other person except that the Board of Directors may adopt by resolution a procedure by which

a stockholder may certify in writing to the Corporation that any shares of its capital stock registered in the name of such stockholder are held for the account of a specified person other than such stockholder are held for the account of a specified person other than such stockholder.

(B) If a stockholder desires that notices and/or dividends shall be sent to a name or address other than the name or address appearing on the stock ledger maintained by the Corporation (or by the transfer agent or registrar, if any), such stockholder shall have the duty to notify the Corporation (or the transfer agent or registrar, if any), in writing, of such desire. Such written notice shall specify the alternate name or address to be used.

SECTION 56. LOCATION OF STOCK LEDGER. A copy of the Corporation's stock ledger containing (i) the name and address of each stockholder, and (ii) the number and shares of stock of each class which the stockholder holds shall be maintained at the Corporation's office located at its headquarters. Such stock ledger may be in written form or any other form capable of being converted into written form within a reasonable time for visual inspection.

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SECTION 57. RECORD DATE. In order that the Corporation may determine the stockholders of record who are entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or entitled to receive payment of any dividend or the allotment of any rights, or to make a determination with respect to stockholders of record for any other proper purpose, the Board of Directors may, in advance, fix a date as the record date for any such determination or meeting. Such date shall not be more than 90 nor less than 10 days before the date of any such meeting, nor more than 90 days prior to the date any other determination is made with respect to stockholders. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting taken pursuant to Section 8 of these Bylaws; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

SECTION 58. LOST, STOLEN OR DESTROYED CERTIFICATES. The Board of Directors may direct that a new certificate be issued in place of any certificate theretofore issued by the Corporation which is claimed to have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate to be lost, stolen or destroyed. When authorizing such issuance of a new certificate, the Board of Directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen or destroyed certificate to advertise the same in such manner as it shall require and/or to give the Corporation a bond in such sum or other security in such form, as it may direct as indemnity against any claim that may be made against the Corporation with respect to the certificate claimed to have been lost, stolen or destroyed.

#### ARTICLE VIII

##### ENGAGEMENT OF ADVISER

SECTION 59. ENGAGEMENT OF ADVISER. The Board of Directors has absolute and exclusive control of the management of the Corporation, its assets and the disposition thereof. The Board of Directors is responsible for the general policies of the Corporation and for general supervision of the business of the Corporation conducted by all officers, agents, employees, advisors, managers or independent contractors of the Corporation as may be necessary to insure that the business conforms to the provisions of these Bylaws. However, the Board of Directors shall not be required to personally conduct all the business of the Corporation, and shall have the power to appoint, employ or contract with any person (including one or more of the directors or any corporation, partnership, or company in which one or more of them may be directors, officers, stockholders, or partners) as the Board of Directors may deem necessary or proper in its sole discretion for the transaction of the business of the Corporation (any such person, the "ADVISER"). The Board of Directors may employ or contract the Adviser and, subject to Section 27 of these Bylaws the Board of Directors may grant or delegate authority to the Adviser as the Board of Directors may in its sole discretion deem necessary or desirable without regard to whether that authority is normally granted or delegated by the Board of Directors.

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#### ARTICLE IX

##### GENERAL PROVISIONS

SECTION 60. DIVIDENDS. Dividends upon the capital stock of the Corporation, subject to the provisions of the Articles of Incorporation, if any, may be declared by the Board of Directors at any regular or special meeting, pursuant to law. Dividends may be paid in cash, in property, or in its own shares, subject to the provisions of law and of the Articles of Incorporation.

SECTION 61. RESERVES. Before payment of any dividend, there may be set aside out of any funds of the Corporation available for dividends such sum or sums as the directors from time to time, in their absolute discretion, think proper as a reserve fund to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the Corporation, or for such other purpose as the directors shall think conducive to the interests of the Corporation, and the directors may modify or abolish any such reserve in the manner in which it was created.

SECTION 62. ANNUAL STATEMENT. The Chief Executive Officer, the President or a Vice President, the Chief Financial Officer or the Treasurer shall prepare or cause to be prepared annually a full and correct statement of the affairs of the Corporation, including a balance sheet and a financial statement of operations for the preceding fiscal year, which shall be submitted at the annual meeting and shall be filed within twenty days thereafter at the principal office of the Corporation in the State of Maryland.

SECTION 63. CHECKS. All checks, drafts, and orders for the payment of money, notes and other evidences of indebtedness, issued in the name of the Corporation shall be signed by such officer or officers as the Board of Directors may from time to time designate.

SECTION 64. FISCAL YEAR. The fiscal year of the Corporation shall end on the last day of December in each year.

SECTION 65. SEAL. The corporate seal shall have inscribed thereon the name of the Corporation, the year of its organization and the words "CORPORATE SEAL, MARYLAND." The seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

SECTION 66. EXECUTION OF CORPORATE INSTRUMENTS. The Board of Directors may, in its discretion, determine the method and designate the signatory officer or officers, or other person or persons, to execute on behalf of the Corporation any corporate instrument or document, or to sign on behalf of the Corporation the corporate name without limitation, or to enter into contracts on behalf of the Corporation, except where otherwise provided by law or these Bylaws and such extension or signature shall be binding upon the Corporation.

SECTION 67. VOTING OF SECURITIES OWNED BY THE CORPORATION. All stock and other securities of other corporations owned or held by the Corporation for itself, or for other parties in any capacity, shall be voted, and all proxies with respect thereto shall be executed, by the person authorized so to do by resolution of the Board of Directors, or, in the absence of such authorization, by the Chairman of the Board of Directors, the Chief Executive Officer, the President, the Chief Operating Officer, the Chief Investment Officer, or any Vice President or Principal.

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SECTION 68. EXECUTION OF OTHER SECURITIES. All bonds, debentures and other corporate securities of the Corporation, other than stock certificates may be signed by the Chairman of the Board of Directors, the Chief Executive Officer, the President, the Chief Operating Officer, or such other person as may be authorized by the Board of Directors, and the corporate seal impressed thereon or a facsimile of such seal imprinted thereon and attested by the signature of the Secretary or an Assistant Secretary, or the Chief Financial Officer or Treasurer or an Assistant Treasurer; provided, however, that where any such bond, debenture or other corporate security shall be authenticated by the manual signature, or where permissible facsimile signature, of a trustee under an indenture pursuant to which such bond, debenture or other corporate security shall be issued, the signatures of the persons signing and attesting the corporate seal on such bond, debenture or other corporate security may be the imprinted facsimile of the signatures of such persons. Interest coupons appertaining to any such bond, debenture or other corporate security, authenticated by a trustee as aforesaid, shall be signed by the Treasurer or an Assistant Treasurer of the Corporation or such other person as may be authorized by the Board of Directors, or bear imprinted thereon the facsimile signature of such person. In case any officer who shall have signed or attested any bond, debenture or other corporate security, or whose facsimile signature shall appear thereon or on any such interest coupon, shall have ceased to be such officer before the bond, debenture or other corporate security so signed or attested shall have been delivered, such bond, debenture or other corporate security nevertheless may be adopted by the Corporation and issued and delivered as though the person who signed the same or whose facsimile signature shall have been used thereon had not ceased to be such officer of the Corporation.

SECTION 69. NOTICE TO PERSON WITH WHOM COMMUNICATION IS UNLAWFUL. Whenever notice is required to be given, under any provision of law or of the Articles of Incorporation or Bylaws of the Corporation, to any person with whom communication is unlawful, the giving of such notice to such person shall not be required and there shall be no duty to apply to any governmental authority or agency for a license or permit to give such notice to such person. Any action or meeting which shall be taken or held without notice to any such person with whom

communication is unlawful shall have the same force and effect as if such notice had been duly given. In the event that the action taken by the Corporation is such as to require the filing of a certificate under any provision of the Maryland General Corporation Law, the certificate shall state, if such is the fact and if notice is required, that notice was given to all persons entitled to receive notice except such persons with whom communication is unlawful.

SECTION 70. LOANS TO OFFICERS. Except as otherwise prohibited by applicable law, the Corporation may lend money to, or guarantee any obligation of, or otherwise assist any officer or other employee of the Corporation or the Adviser, including any officer or employee who is a director of the Corporation or the Adviser, whenever, in the judgment of the Board of Directors, such loan, guarantee or assistance may reasonably be expected to benefit the Corporation. The loan, guarantee or other assistance may be with or without interest and may be unsecured, or secured in such manner as the Board of Directors shall approve, including, without limitation, a pledge of shares of stock of the Corporation. Nothing in these Bylaws shall be deemed to deny, limit or restrict the powers of guaranty or warranty of the Corporation at common law or under any statute.

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SECTION 71. PROVISIONS OF THE BYLAWS IN CONFLICT WITH LAW OR REGULATION.

(A) The provisions of these Bylaws are severable, and if the Board of Directors shall determine, with the advice of counsel, that any one or more of these provisions ("CONFLICTING PROVISIONS") are in conflict with the REIT Provisions, or with other applicable laws and regulations, the Conflicting Provisions shall be deemed never to have constituted a part of these Bylaws, and the Board of Directors shall be able to amend or revise the Bylaws without the vote or assent of the stockholders to the extent necessary to bring the Conflicting Provisions of these Bylaws into conformity with the REIT Provisions or any other applicable law or regulation; provided, however, that this determination shall not affect or impact any of the remaining provisions of these Bylaws or render invalid or improper any action taken or omitted (including but not limited to the election of the Board of Directors) prior to the determination. A certification in recordable form signed by a majority of the Board of Directors setting forth any such determination and reciting that it was duly adopted by the Board of Directors, or a copy of these Bylaws, with the Conflicting Provisions removed and any new provisions added pursuant to the determination, in recordable form signed by a majority of the Board of Directors, shall be conclusive evidence of such determination when lodged in the records of the Corporation. The Board of Directors shall not be liable for failure to make any determination under this Section 71.

(B) If any provisions of these Bylaws shall be held invalid or unenforceable, the invalidity or unenforceability shall attach only to that provision and shall not in any manner affect or render invalid or unenforceable any other provision, and these Bylaws shall be carried out as if the invalid or unenforceable provision were not present.

SECTION 72. AMENDMENTS. These Bylaws may be amended, altered, restated or repealed, or a provision waived as provided in the Articles of Incorporation and these Bylaws.

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INVESTMENT ADVISORY AGREEMENT

THIS INVESTMENT ADVISORY AGREEMENT (this "AGREEMENT") is entered into and made effective as of the 1st day of June 2003 by and between GLADSTONE COMMERCIAL CORPORATION, a Maryland corporation (the "COMPANY"), and GLADSTONE MANAGEMENT CORPORATION, a Delaware corporation (the "ADVISER").

W I T N E S S E T H:

WHEREAS, the Company intends to be treated as a real estate investment trust (REIT);

WHEREAS, the Adviser is an investment adviser registered under the Investment Advisers Act of 1940, as amended (the "ADVISERS Act"), and the rules and regulations promulgated thereunder;

WHEREAS, the Adviser desires to serve as the Company's investment adviser and, in connection therewith, to perform certain services for the Company with respect to the administration of the Company and its investment activities, in all cases under the supervision and control of the Company's Board of Directors and on the terms and subject to the conditions set forth herein; and

WHEREAS, the Company desires to retain the Adviser to serve as its investment adviser and, in connection therewith, to perform certain administrative and investment advisory services under the supervision of the Company's Board of Directors and on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual covenants and agreements of the parties hereto as herein set forth, the parties covenant and agree as follows:

1. APPOINTMENT OF ADVISER; DUTIES OF ADVISER.

(A) The Company hereby retains the Adviser to serve as its investment adviser for the period and on the terms and subject to the conditions as set forth in this Agreement.

(B) Subject to the supervision and control by the Company's Board of Directors, the Adviser shall:

(I) (A) consistent with the Company's investment policies adopted by the Company's Board of Directors, as revised from time to time, manage the investment and reinvestment of the Company's assets;

(B) continuously review, supervise and administer the Company's investment program to determine in its discretion the securities to be purchased or sold and the portion of the Company's assets to be held un-invested;

(C) provide the Company with all required records concerning the Adviser's efforts on behalf of the Company; and

(D) provide regular reports to the Company's Board of Directors concerning the Adviser's activities on behalf of the Company;

(II) (A) consistent with the Company's investment policies adopted by the Company's Board of Directors, as revised from time to time, manage the acquisition and divestiture of real estate and mortgage loans purchased or originated for the account of the Company;

(B) manage the Company's portfolio of real estate and mortgage loans; and

(C) manage any other investments of the Company;

(III) use its best efforts to present the Company with investment opportunities consistent with the Company's investment policies and objectives as adopted by the Company's Board of Directors and as revised from time to time; and

(IV) devote sufficient resources to the business of the Company to discharge its obligations under this Agreement.

(C) The Company's Board of Directors retains, and has the exclusive right, to:

(I) Grant stock compensation to the officers of the Company and any employee of the Adviser;

(II) Hire, fire and control the activities of the Adviser's employees in connection with and to the extent of such employees' work for the Company;

(III) Determine the economic value of the services performed by the Adviser's employees that are assigned to the Company (including wages and the number of units and value of any stock compensation granted); and

(IV) Remit funds sufficient to cover the complete compensation, including all payroll taxes, of the Adviser's employees assigned to the Company, if the Board of Directors so desires.

2. ACCEPTANCE BY ADVISER.

The Adviser hereby accepts appointment as investment adviser to the Company on the terms and conditions set forth on this Agreement, and agrees to discharge the foregoing responsibilities in compliance with the investment objectives, policies and limitations set forth in the Company's prospectus (as it may be amended or supplemented from time to time, the "PROSPECTUS") and applicable laws and regulations, and under the supervision and control of the Company's Board of Directors.

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3. COMPENSATION.

(A) The Adviser shall pay all of its own costs and expenses, including such costs and expenses as the Adviser may incur in the performance of its duties pursuant to this Agreement. In consideration for the Adviser's services as set forth in this Agreement, the Company shall reimburse the Adviser for expenses that it incurs as described in this Section 3.

(B) The Company will reimburse the Adviser promptly, against the Adviser's voucher, for any expenses incurred the by the Adviser for the Company's account. Without limitation, such expenses shall include (i) expenses of the Company's organization, (ii) expenses incurred in connection with the Company's initial public offering, (iii) expenses of any offering and sale by the Company of its securities, (iv) the fees and disbursements of the Company's counsel, accountants, custodian, transfer agent and registrar, (v) fees and expenses incurred in producing and effecting filings with federal and state securities administrators, (vi) costs of the Company's periodic reports to and other communications with the Company's stockholders, (vii) fees and expenses of members of the Company's Board of Directors who are not directors, managers, officers or employees of the Adviser, and are not managers, officers or employees of any entity managed by the Adviser, (viii) fees of members of the Company's Board of Directors who are such directors, managers, officers or employees, and (ix) premiums for any fidelity bond and similar insurance maintained by the Company.

(C) The Company shall also reimburse the Adviser promptly, against the Adviser's voucher, for all fees charged by third parties that are directly related to the Company's business, which may include, without limitation (i) any origination fee with respect to any loan, lease or investment made by the Company, and (ii) all transaction costs incident to the acquisition and disposition by the Company of securities, leases, mortgage loans, real estate and other investments and assets, including, without limitation, legal and accounting fees and other professional or technical fees and expenses (e.g., credit reports, appraisals, title search and delivery charges, costs of specialized consultants such as accountants or industry-specific technical experts, and deal-specific travel expenses) incurred in monitoring, negotiating and working-out such securities, leases, mortgage loans or real estate and other investments and assets, as well as responding to any litigation or other disputes arising therefrom. All such origination fees described in clause (i) above shall be reviewed as of the end of each calendar quarter by the Company's Board of Directors.

(D) The Company shall also reimburse the Adviser for its pro rata portion of the Adviser's total operating expenses not incurred for direct benefit of any party whom the Adviser manages (e.g., payroll and other overhead expenses) ("OVERHEAD"). This expense reimbursement is the equivalent of a management fee and is hereafter referred to as the "MANAGEMENT FEE." The Management Fee shall be computed monthly on the following basis:

(I) The Adviser shall calculate the total aggregate hours of service performed by all of its employees, directors and associates during the month, and that number shall be the "DENOMINATOR."

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(II) The Adviser and each of the Adviser's employees, directors and associates shall calculate the total aggregate number of hours of service performed on behalf of the Company during the month, and that number shall be the "NUMERATOR."

(III) The percentage derived by dividing the Numerator by the Denominator shall be the percentage of all Overhead that shall be billed to the Company for that month (the "MONTHLY PERCENTAGE").

(IV) The Adviser will estimate its total operating



expenses (less expenses incurred directly for the benefit of parties that the Adviser manages, such as those expenses described in Section 3(b) and 3(c)) for the month (the "ESTIMATED OVERHEAD"), based on historical monthly expenses, and make any adjustments to the prior monthly bills in order to reconcile the actual results with the earlier estimates. The Adviser shall then calculate the month's Management Fee by multiplying the Monthly Percentage by the Estimated Overhead. The Adviser will then bill the Company for an amount equal to Management Fee for that month. The expenses will be billed to the Company on the first day of each month and shall be paid within three days thereafter.

(V) The Management Fee is subject to an annual maximum of 2.5% of the Company's average invested assets (as determined jointly by the Company and the Adviser) (the "ANNUAL MANAGEMENT FEE CAP") during each calendar year. The Adviser shall reimburse the Company no less frequently than annually for the amount by which amounts billed to and paid by the Company exceed the Management Fee Cap during a given year.

(VI) To the extent that aggregate Management Fees payable or reimbursable by the Company exceed the Annual Management Fee Cap (such amount, the "EXCESS FEES") and the Company's independent directors determine, by majority vote, that the excess Management Fees were justified based on unusual and nonrecurring factors which they deem sufficient, the Company may reimburse the Adviser in future years for the full amount of the Excess Fees, or any portion thereof, but only to the extent that the reimbursement would not cause the Company's Management Fees and Excess Fees to collectively exceed the Annual Management Fee Cap in any year.

(VII) In the event this Agreement is terminated, any compensation to which the Adviser may be entitled to receive pursuant to this Section 3(d) shall be computed as of the period ending on the last business day on which this Agreement is in effect, subject to pro rata adjustment based on the number of days elapsed in the current month as a percentage of the total number of days in such month, as appropriate.

(E) The Company shall establish an Equity Incentive Plan for the officers and directors of the Company. The plan shall be administered by the Board of Directors or by its Compensation Committee if the Board of Directors delegates that authority to the Compensation Committee.

#### 4. LIMITATION OF LIABILITY.

In the absence of: (i) willful misfeasance, bad faith or gross negligence on the part of the Adviser in the performance of its obligations and duties hereunder; (ii) reckless disregard by the Adviser of its obligations and duties hereunder; or (iii) a loss resulting from a breach of fiduciary duty with respect to the receipt of compensation for services, the Adviser shall not be subject to liability to the Company or any of its stockholders for any error of judgment, mistake of law or any other act or omission in the course of, or connected with, its rendering of services hereunder including, without limitation, for any losses that may be sustained in connection with the purchase, holding, redemption or sale of any security by the Adviser on behalf of the Company.

#### 5. EXCLUSIVITY.

The services provided by the Adviser hereunder are not exclusive and the Adviser shall therefore remain free to render such services to others.

#### 6. RECORDS.

The Adviser agrees to preserve the records required by Rule 204-2 promulgated under the Advisers Act for the period specified therein.

#### 7. WRITTEN DISCLOSURE STATEMENT.

The Adviser has previously delivered to the Company a written disclosure statement as required by Section 204-3(a) of the Advisers Act in the form of either a copy of Part II of the Adviser's Form ADV which complies with Section 204-1(b) of the Advisers Act or a written document containing at least the information required by Part II of Form ADV. Such written disclosure statement was delivered by the Adviser to the Company within the time period specified by Section 204-1(b) of the Advisers Act.

#### 8. DURATION.

This Agreement shall be effective beginning on the date set forth in the preamble hereof, and shall remain in force through December 31, 2006. Upon expiration of the initial term, the term of this Agreement shall be automatically extended for successive one (1) year periods, unless either the Company or the Adviser notifies the other party of its intention not to renew this Agreement at least 120 days prior to the end of the term.

#### 9. TERMINATION.

(A) This Agreement may be terminated by

(I) the Company's Board of Directors, immediately, for Cause or upon the Bankruptcy of the Adviser;

(II) the vote of a majority of the Company's Independent Directors upon sixty (60) days prior written notice to the Adviser; or

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(III) the Adviser, immediately, with Good Reason.

(B) Definitions. For the purposes of this Section 9, the following terms shall have the following definitions:

(I) "CAUSE" shall mean fraud, criminal conduct, willful or negligent breach of fiduciary duty, or the commission of a material breach of this Agreement;

(II) "GOOD REASON" shall mean either (A) a failure to obtain a satisfactory agreement from any successor to the Company to assume and agree to perform the Company's obligations under this Agreement, or (B) a material breach of this Agreement; and

(III) "BANKRUPTCY" shall mean the happening of any of the following: (A) the filing of an application by the Adviser for the appointment of a trustee, receiver or similar person over all or substantially all of his or its assets; (B) the filing by the Adviser of a voluntary petition in bankruptcy or the filing of a pleading in any court of record admitting in writing the Adviser's inability to pay substantially all of its debts as they become due; (C) the making by the Adviser of a general assignment for the benefit of creditors in connection with the winding up or liquidation of the Adviser's business; (D) the expiration of 60 calendar days after a petition for involuntary bankruptcy shall have been filed against the Adviser, or the appointment of, or the taking of possession by, a receiver, custodian, trustee or liquidator of the Adviser or of a substantial part of its property shall have occurred, provided that the same shall not have been vacated or dismissed within such 60-day period or there shall be remaining open any motion to vacate or dismiss such petition filed before the expiration of any such 60-day period; provided that such motion shall not remain open in excess of 120 calendar days in the aggregate; (E) the filing by the Adviser of an answer admitting the material allegations of, or its consenting to, or defaulting in answering, a bankruptcy petition filed against the Adviser in any bankruptcy proceeding; or (F) the entry of an order, judgment, or decree by any court of competent jurisdiction adjudicating the Adviser bankrupt or appointing a trustee over its assets, and such order, judgment or decree continuing unstayed and in effect for a period of 60 consecutive calendar days.

#### 10. AMENDMENTS.

This Agreement may be amended with the mutual consent of the parties; PROVIDED, HOWEVER, that the Company shall not consent to any such amendment unless such amendment shall be approved by (i) a majority of the Company's directors and (ii) a majority the Company's independent directors.

#### 11. SEVERABILITY.

If any term or condition of this Agreement shall be found to be invalid or unenforceable to any extent or in any application, the remainder of this Agreement, including such term or condition, except to the extent or in such application such term or condition is held invalid or unenforceable, shall not be affected thereby, and each and every term and condition of this Agreement shall be valid and enforceable to the fullest extent and in the broadest application permitted by law.

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#### 12. CAPTIONS.

The captions of this Agreement are included for convenience only and in no way define or limit any of the provisions hereof or otherwise affect their construction or effect.

#### 13. DEFINITIONS.

For purposes of this Agreement, "MAJORITY OF THE OUTSTANDING VOTING SECURITIES," "ASSIGNMENT" and "INTERESTED PERSON" shall have the respective meanings assigned to them in the Investment Company Act of 1940, as amended (the "INVESTMENT COMPANY ACT"), subject, however, to such exemptions as may be granted by the Securities and Exchange Commission pursuant to its rule-making authority as set forth in the Investment Company Act or the Advisers Act, as the case may be. "INDEPENDENT DIRECTOR" shall have the meaning ascribed to such term under the rules of the Nasdaq Stock Market or such other securities market on

which the securities of the Company are traded.

14. NOTICES.

All notices required or permitted to be delivered under or pursuant to this Agreement shall be so delivered by certified mail, postage prepaid, as follows:

If to the Adviser: Gladstone Management Corporation  
1750 Tysons Blvd., 4th Floor  
McLean, VA 22102  
Attn: President

If to the Company: Gladstone Commercial Corporation  
1750 Tysons Blvd., 4th Floor  
McLean, VA 22102  
Attn: Chairman

Any notice delivered pursuant to this Section 14 shall be deemed delivered on the third day following its deposit in the United States mail or the date such notice is actually received by the addressee, whichever shall occur first.

15. ASSIGNMENT.

This Agreement is generally not assignable or transferable by either party hereto without the prior written consent of the other party. HOWEVER, (i) the Adviser may assign this Agreement to an affiliate of the Adviser without the Company's consent if the Adviser guarantees the performance of the obligations hereunder, and (ii) either party may assign or transfer this Agreement to a successor in interest.

16. ENTIRE AGREEMENT.

This Agreement contains the entire agreement of the parties with respect to the matters referred to herein and supersedes all prior agreements, negotiations, commitments or understandings.

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17. COUNTERPARTS.

This Agreement may be executed in any number of counterparts, each of which when so executed and delivered shall be taken to be an original and together shall constitute one and the same document.

18. GOVERNING LAW.

This Agreement shall be construed in accordance with the laws of the State of Virginia and the applicable provisions of the Advisers Act.

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8.

IN WITNESS WHEREOF, the undersigned have executed and delivered this Agreement as of the date first above written.

GLADSTONE COMMERCIAL CORPORATION

By: \_\_\_\_\_  
David Gladstone  
Chairman of the Board and CEO

GLADSTONE MANAGEMENT CORPORATION

By: \_\_\_\_\_  
Terry Brubaker  
President and COO

9.

GLADSTONE COMMERCIAL CORPORATION

2003 EQUITY INCENTIVE PLAN

ADOPTED: JUNE 10, 2003  
APPROVED BY STOCKHOLDERS: JUNE 10, 2003  
TERMINATION DATE: JUNE 9, 2013

1. PURPOSES.

(a) ELIGIBLE STOCK AWARD RECIPIENTS. The persons eligible to receive Stock Awards are Employees, Directors and Consultants.

(b) AVAILABLE STOCK AWARDS. The purpose of the Plan is to provide a means by which eligible recipients of Stock Awards may be given an opportunity to benefit from increases in value of the Common Stock through the granting of the following Stock Awards: (i) Incentive Stock Options, (ii) Nonstatutory Stock Options, (iii) stock bonuses and (iv) rights to acquire restricted stock.

(c) GENERAL PURPOSE. The Company, by means of the Plan, seeks to retain the services of the group of persons eligible to receive Stock Awards, to secure and retain the services of new members of this group and to provide incentives for such persons to exert maximum efforts for the success of the Company and its Affiliates.

2. DEFINITIONS.

(a) "AFFILIATE" means any parent corporation or subsidiary corporation of the Company, whether now or hereafter existing, as those terms are defined in Sections 424(e) and (f), respectively, of the Code and any investment adviser or external management company providing services to the Company.

(b) "BOARD" means the Board of Directors of the Company.

(c) "CAPITALIZATION ADJUSTMENT" has the meaning ascribed to that term in Section 11(a).

(d) "CHANGE IN CONTROL" means the occurrence, in a single transaction or in a series of related transactions, of any one or more of the following events:

(i) any Exchange Act Person becomes the Owner, directly or indirectly, of securities of the Company representing more than fifty percent (50%) of the combined voting power of the Company's then outstanding securities other than by virtue of a merger, consolidation or similar transaction. Notwithstanding the foregoing, a Change in Control shall not be deemed to occur (A) on account of the acquisition of securities of the Company by an institutional investor, any affiliate thereof or any other Exchange Act Person that acquires the Company's securities in a transaction or series of related transactions that are primarily a private financing transaction for the Company or (B) solely because the level of Ownership held by any

Exchange Act Person (the "Subject Person") exceeds the designated percentage threshold of the outstanding voting securities as a result of a repurchase or other acquisition of voting securities by the Company reducing the number of shares outstanding, provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of voting securities by the Company, and after such share acquisition, the Subject Person becomes the Owner of any additional voting securities that, assuming the repurchase or other acquisition had not occurred, increases the percentage of the then outstanding voting securities Owned by the Subject Person over the designated percentage threshold, then a Change in Control shall be deemed to occur;

(ii) there is consummated a merger, consolidation or similar transaction involving (directly or indirectly) the Company if, immediately after the consummation of such merger, consolidation or similar transaction, the stockholders of the Company immediately prior thereto do not Own, directly or indirectly, either (A) outstanding voting securities representing more than fifty percent (50%) of the combined outstanding voting power of the surviving Entity in such merger, consolidation or similar transaction or (B) more than fifty percent (50%) of the combined outstanding voting power of the parent of the surviving Entity in such merger, consolidation or similar transaction;

(iii) the stockholders of the Company approve or the Board approves a plan of complete dissolution or liquidation of the Company, or a complete dissolution or liquidation of the Company shall otherwise occur;

(iv) there is consummated a sale, lease, license or other disposition of all or substantially all of the consolidated assets of the Company and its Subsidiaries, other than a sale, lease, license or other disposition of all or substantially all of the consolidated assets of the Company and its Subsidiaries to an Entity, more than fifty percent (50%) of the combined voting power of the voting securities of which are Owned by stockholders of the Company in substantially the same proportion as their Ownership of the Company immediately prior to such sale, lease, license or other disposition; or

The term Change in Control shall not include a sale of assets, merger or other transaction effected exclusively for the purpose of changing the domicile of the Company.

Notwithstanding the foregoing or any other provision of this Plan, the definition of Change in Control (or any analogous term) in an individual written agreement between the Company or any Affiliate and the Participant shall supersede the foregoing definition with respect to Stock Awards subject to such agreement (it being understood, however, that if no definition of Change in Control or any analogous term is set forth in such an individual written agreement, the foregoing definition shall apply).

(e) "CODE" means the Internal Revenue Code of 1986, as amended.

(f) "COMMITTEE" means a committee of one or more members of the Board appointed by the Board in accordance with Section 3(c).

(g) "COMMON STOCK" means the common stock of the Company.

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(h) "COMPANY" means Gladstone Commercial Corporation, a Maryland corporation.

(i) "CONSULTANT" means any person, including an advisor, (i) engaged by the Company or an Affiliate to render consulting or advisory services and who is compensated for such services or (ii) serving as a member of the Board of Directors of an Affiliate and who is compensated for such services. However, the term "Consultant" shall not include Directors who are not compensated by the Company for their services as Directors, and the payment of a director's fee by the Company for services as a Director shall not cause a Director to be considered a "Consultant" for purposes of the Plan.

(j) "CONTINUOUS SERVICE" means that the Participant's service with the Company or an Affiliate, whether as an Employee, Director or Consultant, is not interrupted or terminated. A change in the capacity in which the Participant renders service to the Company or an Affiliate as an Employee, Consultant or Director or a change in the entity for which the Participant renders such service, provided that there is no interruption or termination of the Participant's service with the Company or an Affiliate, shall not terminate a Participant's Continuous Service. For example, a change in status from an Employee of the Company to a Consultant to an Affiliate or to a Director shall not constitute an interruption of Continuous Service. The Board or the chief executive officer of the Company, in that party's sole discretion, may determine whether Continuous Service shall be considered interrupted in the case of any leave of absence approved by that party, including sick leave, military leave or any other personal leave. Notwithstanding the foregoing, a leave of absence shall be treated as Continuous Service for purposes of vesting in a Stock Award only to such extent as may be provided in the Company's leave of absence policy or in the written terms of the Participant's leave of absence.

(k) "CORPORATE TRANSACTION" means the occurrence, in a single transaction or in a series of related transactions, of any one or more of the following events:

(i) a sale or other disposition of all or substantially all, as determined by the Board in its discretion, of the consolidated assets of the Company and its Subsidiaries;

(ii) a sale or other disposition of at least ninety percent (90%) of the outstanding securities of the Company;

(iii) a merger, consolidation or similar transaction following which the Company is not the surviving corporation; or

(iv) a merger, consolidation or similar transaction following which the Company is the surviving corporation but the shares of Common Stock outstanding immediately preceding the merger, consolidation or similar transaction are converted or exchanged by virtue of the merger, consolidation or similar transaction into other property, whether in the form of securities, cash or otherwise.

(l) "COVERED EMPLOYEE" means the chief executive officer and the four (4) other highest compensated officers of the Company for whom total

compensation is required to be reported to stockholders under the Exchange Act, as determined for purposes of Section 162(m) of the Code.

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(m) "DIRECTOR" means a member of the Board.

(n) "DISABILITY" means the permanent and total disability of a person within the meaning of Section 22(e)(3) of the Code.

(o) "EMPLOYEE" means any person employed by the Company or an Affiliate. Service as a Director or payment of a director's fee by the Company for such service or for service as a member of the Board of Directors of an Affiliate shall not be sufficient to constitute "employment" by the Company or an Affiliate.

(p) "ENTITY" means a corporation, partnership or other entity.

(q) "EXCHANGE ACT" means the Securities Exchange Act of 1934, as amended.

(r) "EXCHANGE ACT PERSON" means any natural person, Entity or "group" (within the meaning of Section 13(d) or 14(d) of the Exchange Act), except that "Exchange Act Person" shall not include (A) the Company or any Subsidiary of the Company, (B) any employee benefit plan of the Company or any Subsidiary of the Company or any trustee or other fiduciary holding securities under an employee benefit plan of the Company or any Subsidiary of the Company, (C) an underwriter temporarily holding securities pursuant to an offering of such securities, or (D) an Entity Owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their Ownership of stock of the Company.

(s) "FAIR MARKET VALUE" means, as of any date, the value of the Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or traded on the Nasdaq National Market or the Nasdaq SmallCap Market, the Fair Market Value of a share of Common Stock shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or market (or the exchange or market with the greatest volume of trading in the Common Stock) on the last market trading day prior to the day of determination, as reported in The Wall Street Journal or such other source as the Board deems reliable.

(ii) In the absence of such markets for the Common Stock, the Fair Market Value shall be determined in good faith by the Board.

(t) "INCENTIVE STOCK OPTION" means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder.

(u) "NON-EMPLOYEE DIRECTOR" means a Director who either (i) is not currently an employee or officer of the Company or its parent or a subsidiary, does not receive compensation, either directly or indirectly, from the Company or its parent or a subsidiary, for services rendered as a consultant or in any capacity other than as a Director (except for an amount as to which disclosure would not be required under Item 404(a) of Regulation S-K promulgated pursuant to the Securities Act ("Regulation S-K")), does not possess an interest in any other transaction for which disclosure would be required under Item 404(a) of Regulation S-K, and is not engaged in

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a business relationship for which disclosure would be required pursuant to Item 404(b) of Regulation S-K; or (ii) is otherwise considered a "non-employee director" for purposes of Rule 16b-3.

(v) "NONSTATUTORY STOCK OPTION" means an Option not intended to qualify as an Incentive Stock Option.

(w) "OFFICER" means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

(x) "OPTION" means an Incentive Stock Option or a Nonstatutory Stock Option granted pursuant to the Plan.

(y) "OPTION AGREEMENT" means a written agreement between the Company and an Optionholder evidencing the terms and conditions of an individual Option grant. Each Option Agreement shall be subject to the terms and conditions of the Plan.

(z) "OPTIONHOLDER" means a person to whom an Option is granted pursuant to the Plan or, if applicable, such other person who holds an outstanding Option.

(aa) "OUTSIDE DIRECTOR" means a Director who either (i) is not a current employee of the Company or an "affiliated corporation" (within the meaning of Treasury Regulations promulgated under Section 162(m) of the Code), is not a former employee of the Company or an "affiliated corporation" who receives compensation for prior services (other than benefits under a tax-qualified retirement plan) during the taxable year, has not been an officer of the Company or an "affiliated corporation", and does not receive remuneration from the Company or an "affiliated corporation," either directly or indirectly, in any capacity other than as a Director or (ii) is otherwise considered an "outside director" for purposes of Section 162(m) of the Code.

(bb) "OWN," "OWNED," "OWNER," "OWNERSHIP" A person or Entity shall be deemed to "Own," to have "Owned," to be the "Owner" of, or to have acquired "Ownership" of securities if such person or Entity, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares voting power, which includes the power to vote or to direct the voting, with respect to such securities.

(cc) "PARTICIPANT" means a person to whom a Stock Award is granted pursuant to the Plan or, if applicable, such other person who holds an outstanding Stock Award.

(dd) "PLAN" means this Gladstone Commercial Corporation 2003 Equity Incentive Plan.

(ee) "RULE 16B-3" means Rule 16b-3 promulgated under the Exchange Act or any successor to Rule 16b-3, as in effect from time to time.

(ff) "SECURITIES ACT" means the Securities Act of 1933, as amended.

(gg) "STOCK AWARD" means any right granted under the Plan, including an Option, a stock bonus and a right to acquire restricted stock.

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(hh) "STOCK AWARD AGREEMENT" means a written agreement between the Company and a holder of a Stock Award evidencing the terms and conditions of an individual Stock Award grant. Each Stock Award Agreement shall be subject to the terms and conditions of the Plan.

(ii) "SUBSIDIARY" means, with respect to the Company, (i) any corporation of which more than fifty percent (50%) of the outstanding capital stock having ordinary voting power to elect a majority of the board of directors of such corporation (irrespective of whether, at the time, stock of any other class or classes of such corporation shall have or might have voting power by reason of the happening of any contingency) is at the time, directly or indirectly, Owned by the Company, and (ii) any partnership in which the Company has a direct or indirect interest (whether in the form of voting or participation in profits or capital contribution) of more than fifty percent (50%).

(jj) "TEN PERCENT STOCKHOLDER" means a person who Owns (or is deemed to Own pursuant to Section 424(d) of the Code) stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or of any of its Affiliates.

### 3. ADMINISTRATION.

(a) ADMINISTRATION BY BOARD. The Board shall administer the Plan unless and until the Board delegates administration to a Committee, as provided in Section 3(c).

(b) POWERS OF BOARD. The Board shall have the power, subject to, and within the limitations of, the express provisions of the Plan:

(i) To determine from time to time which of the persons eligible under the Plan shall be granted Stock Awards; when and how each Stock Award shall be granted; what type or combination of types of Stock Award shall be granted; the provisions of each Stock Award granted (which need not be identical), including the time or times when a person shall be permitted to receive Common Stock pursuant to a Stock Award; and the number of shares of Common Stock with respect to which a Stock Award shall be granted to each such person.

(ii) To construe and interpret the Plan and Stock Awards granted under it, and to establish, amend and revoke rules and regulations for its administration. The Board, in the exercise of this power, may correct any defect, omission or inconsistency in the Plan or in any Stock Award Agreement,

in a manner and to the extent it shall deem necessary or expedient to make the Plan fully effective.

(iii) To effect, at any time and from time to time, with the consent of any adversely affected Optionholder, (1) the reduction of the exercise price of any outstanding Option under the Plan, (2) the cancellation of any outstanding Option under the Plan and the grant in substitution therefor of (A) a new Option under the Plan covering the same or a different number of shares of Common Stock, (B) a stock bonus, (C) the right to acquire restricted stock, and/or (D) cash, or (3) any other action that is treated as a repricing under generally accepted accounting principles.

(iv) To amend the Plan or a Stock Award as provided in Section 12.

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(v) To terminate or suspend the Plan as provided in Section 13.

(vi) Generally, to exercise such powers and to perform such acts as the Board deems necessary or expedient to promote the best interests of the Company and that are not in conflict with the provisions of the Plan.

(c) DELEGATION TO COMMITTEE.

(i) GENERAL. The Board may delegate administration of the Plan to a Committee or Committees of one (1) or more members of the Board, and the term "Committee" shall apply to any person or persons to whom such authority has been delegated. If administration is delegated to a Committee, the Committee shall have, in connection with the administration of the Plan, the powers theretofore possessed by the Board, including the power to delegate to a subcommittee any of the administrative powers the Committee is authorized to exercise (and references in this Plan to the Board shall thereafter be to the Committee or subcommittee), subject, however, to such resolutions, not inconsistent with the provisions of the Plan, as may be adopted from time to time by the Board. The Board may abolish the Committee at any time and reconstitute the Board the administration of the Plan.

(ii) SECTION 162(m) AND RULE 16B-3 COMPLIANCE. In the discretion of the Board, the Committee may consist solely of two or more Outside Directors, in accordance with Section 162(m) of the Code, and/or solely of two or more Non-Employee Directors, in accordance with Rule 16b-3. In addition, the Board or the Committee may delegate to a committee of one or more members of the Board the authority to grant Stock Awards to eligible persons who are either (a) not then Covered Employees and are not expected to be Covered Employees at the time of recognition of income resulting from such Stock Award, (b) not persons with respect to whom the Company wishes to comply with Section 162(m) of the Code, or (c) not then subject to Section 16 of the Exchange Act.

(d) EFFECT OF BOARD'S DECISION. All determinations, interpretations and constructions made by the Board in good faith shall not be subject to review by any person and shall be final, binding and conclusive on all persons.

4. SHARES SUBJECT TO THE PLAN.

(a) SHARE RESERVE. Subject to the provisions of Section 11(a) relating to Capitalization Adjustments, the Common Stock that may be issued pursuant to Stock Awards shall not exceed in the aggregate six hundred twenty five thousand (625,000) shares.

(b) REVERSION OF SHARES TO THE SHARE RESERVE. If any Stock Award shall for any reason expire or otherwise terminate, in whole or in part, without having been exercised in full, or if any shares of Common Stock issued to a Participant pursuant to a Stock Award are forfeited back to or repurchased by the Company because of or in connection with the failure to meet a contingency or condition required to vest such shares in the Participant, the shares of Common Stock that have not been acquired, as well as such Stock Award or the shares of Common Stock forfeited or repurchased under such Stock Award shall revert to and again become available for issuance under the Plan; provided, however, that subject to the provisions of Section 11(a) relating to Capitalization Adjustments, the aggregate maximum number of shares of Common

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Stock that may be issued as Incentive Stock Options shall be six hundred twenty five thousand (625,000) shares.

(b) SOURCE OF SHARES. The shares of Common Stock subject to the Plan may be unissued shares or reacquired shares, bought on the market or otherwise.

5. ELIGIBILITY.



(a) ELIGIBILITY FOR SPECIFIC STOCK AWARDS. Incentive Stock Options may be granted only to Employees. Stock Awards other than Incentive Stock Options may be granted to Employees, Directors and Consultants.

(b) TEN PERCENT STOCKHOLDERS. A Ten Percent Stockholder shall not be granted an Incentive Stock Option unless the exercise price of such Option is at least one hundred ten percent (110%) of the Fair Market Value of the Common Stock on the date of grant and the Option is not exercisable after the expiration of five (5) years from the date of grant.

(c) SECTION 162(m) LIMITATION ON ANNUAL GRANTS. Subject to the provisions of Section 11(a) relating to Capitalization Adjustments, no Employee shall be eligible to be granted Options covering more than three hundred twelve thousand five hundred (312,500) shares of Common Stock during any calendar year.

(d) CONSULTANTS. A Consultant shall not be eligible for the grant of a Stock Award if, at the time of grant, a Form S-8 Registration Statement under the Securities Act ("Form S-8") is not available to register either the offer or the sale of the Company's securities to such Consultant because of the nature of the services that the Consultant is providing to the Company, because the Consultant is not a natural person, or because of any other rule governing the use of Form S-8, unless the Company determines both (i) that such grant (A) shall be registered in another manner under the Securities Act (e.g., on a Form S-3 Registration Statement) or (B) does not require registration under the Securities Act in order to comply with the requirements of the Securities Act, if applicable, and (ii) that such grant complies with the securities laws of all other relevant jurisdictions.

(e) LIMITATION ON OWNERSHIP. Unless otherwise approved by the Board, no Stock Award may be granted to a Participant who, upon exercise of all Options then held by such Participant, would Own in excess of 9.8% of the outstanding shares of capital stock of the Company.

#### 6. OPTION PROVISIONS.

Each Option shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. All Options shall be separately designated Incentive Stock Options or Nonstatutory Stock Options at the time of grant, and, if certificates are issued, a separate certificate or certificates shall be issued for shares of Common Stock purchased on exercise of each type of Option. The provisions of separate Options need not be identical, but, subject to such differing provisions as may be contained in any individually negotiated written agreement between the Company and a Participant, each Option shall include (through incorporation of provisions hereof by reference in the Option or otherwise) the substance of each of the following provisions:

(a) TERM. Subject to the provisions of Section 5(b) regarding Ten Percent Stockholders, no Incentive Stock Option shall be exercisable after the expiration of ten (10) years from the date on which it was granted.

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(b) EXERCISE PRICE OF AN INCENTIVE STOCK OPTION. Subject to the provisions of Section 5(b) regarding Ten Percent Stockholders, the exercise price of each Incentive Stock Option shall be not less than one hundred percent (100%) of the Fair Market Value of the Common Stock subject to the Option on the date the Option is granted. Notwithstanding the foregoing, an Incentive Stock Option may be granted with an exercise price lower than that set forth in the preceding sentence if such Option is granted pursuant to an assumption or substitution for another option in a manner satisfying the provisions of Section 424(a) of the Code.

(c) EXERCISE PRICE OF A NONSTATUTORY STOCK OPTION. The exercise price of each Nonstatutory Stock Option shall be not less than eighty-five percent (85%) of the Fair Market Value of the Common Stock subject to the Option on the date the Option is granted. Notwithstanding the foregoing, a Nonstatutory Stock Option may be granted with an exercise price lower than that set forth in the preceding sentence if such Option is granted pursuant to an assumption or substitution for another option in a manner satisfying the provisions of Section 424(a) of the Code.

(d) CONSIDERATION. The purchase price of Common Stock acquired pursuant to an Option shall be paid, to the extent permitted by applicable statutes and regulations, either (i) in cash at the time the Option is exercised or (ii) at the discretion of the Board at the time of the grant of the Option (or subsequently in the case of a Nonstatutory Stock Option) (1) by delivery to the Company of other Common Stock, (2) according to a deferred payment or other similar arrangement with the Optionholder or (3) in any other form of legal consideration that may be acceptable to the Board. Unless otherwise specifically provided in the Option, the purchase price of Common Stock acquired pursuant to an Option that is paid by delivery to the Company of other Common Stock acquired, directly or indirectly from the Company, shall be paid only by shares

of the Common Stock of the Company that have been held for more than six (6) months (or such longer or shorter period of time required to avoid a charge to earnings for financial accounting purposes). To the extent applicable state corporate laws so require, payment of the Common Stock's "par value," as defined by applicable state statutes, shall be made in cash and not by deferred payment

In the case of any deferred payment arrangement, interest shall be compounded at least annually and shall be charged at the minimum rate of interest necessary to avoid (1) the treatment as interest, under any applicable provisions of the Code, of any amounts other than amounts stated to be interest under the deferred payment arrangement and (2) the treatment of the Option as a variable award for financial accounting purposes.

(e) TRANSFERABILITY OF AN INCENTIVE STOCK OPTION. An Incentive Stock Option shall not be transferable except by will or by the laws of descent and distribution and shall be exercisable during the lifetime of the Optionholder only by the Optionholder. Notwithstanding the foregoing, the Optionholder may, by delivering written notice to the Company, in a form satisfactory to the Company, designate a third party who, in the event of the death of the Optionholder, shall thereafter be entitled to exercise the Option.

(f) TRANSFERABILITY OF A NONSTATUTORY STOCK OPTION. A Nonstatutory Stock Option shall be transferable to the extent provided in the Option Agreement. If the Nonstatutory Stock

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Option does not provide for transferability, then the Nonstatutory Stock Option shall not be transferable except by will or by the laws of descent and distribution and shall be exercisable during the lifetime of the Optionholder only by the Optionholder. Notwithstanding the foregoing, the Optionholder may, by delivering written notice to the Company, in a form satisfactory to the Company, designate a third party who, in the event of the death of the Optionholder, shall thereafter be entitled to exercise the Option.

(g) VESTING GENERALLY. The total number of shares of Common Stock subject to an Option may, but need not, vest and therefore become exercisable in periodic installments that may, but need not, be equal. The Option may be subject to such other terms and conditions on the time or times when it may be exercised (which may be based on performance or other criteria) as the Board may deem appropriate. The vesting provisions of individual Options may vary. The provisions of this Section 6(g) are subject to any Option provisions governing the minimum number of shares of Common Stock as to which an Option may be exercised.

(h) TERMINATION OF CONTINUOUS SERVICE. In the event that an Optionholder's Continuous Service terminates (other than upon the Optionholder's death or Disability), the Optionholder may exercise his or her Option (to the extent that the Optionholder was entitled to exercise such Option as of the date of termination) but only within such period of time ending on the earlier of (i) the date three (3) months following the termination of the Optionholder's Continuous Service (or such longer or shorter period specified in the Option Agreement or (ii) the expiration of the term of the Option as set forth in the Option Agreement. If, after termination, the Optionholder does not exercise his or her Option within the time specified in the Option Agreement, the Option shall terminate.

(i) EXTENSION OF TERMINATION DATE. An Optionholder's Option Agreement may also provide that if the exercise of the Option following the termination of the Optionholder's Continuous Service (other than upon the Optionholder's death or Disability) would be prohibited at any time solely because the issuance of shares of Common Stock would violate the registration requirements under the Securities Act, then the Option shall terminate on the earlier of (i) the expiration of the term of the Option set forth in Section 6(a) or (ii) the expiration of a period of three (3) months after the termination of the Optionholder's Continuous Service during which the exercise of the Option would not be in violation of such registration requirements.

(j) DISABILITY OF OPTIONHOLDER. In the event that an Optionholder's Continuous Service terminates as a result of the Optionholder's Disability, the Optionholder may exercise his or her Option (to the extent that the Optionholder was entitled to exercise such Option as of the date of termination), but only within such period of time ending on the earlier of (i) the date twelve (12) months following such termination (or such longer or shorter period specified in the Option Agreement or (ii) the expiration of the term of the Option as set forth in the Option Agreement. If, after termination, the Optionholder does not exercise his or her Option within the time specified herein, the Option shall terminate.

(k) DEATH OF OPTIONHOLDER. In the event that (i) an Optionholder's Continuous Service terminates as a result of the Optionholder's death or (ii) the Optionholder dies within the period (if any) specified in the Option Agreement after the termination of the Optionholder's Continuous Service for a

reason other than death, then the Option may be exercised (to the extent

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the Optionholder was entitled to exercise such Option as of the date of death) by the Optionholder's estate, by a person who acquired the right to exercise the Option by bequest or inheritance or by a person designated to exercise the option upon the Optionholder's death pursuant to Section 6(e) or 6(f), but only within the period ending on the earlier of (1) the date eighteen (18) months following the date of death (or such longer or shorter period specified in the Option Agreement or (2) the expiration of the term of such Option as set forth in the Option Agreement. If, after death, the Option is not exercised within the time specified herein, the Option shall terminate.

(1) EARLY EXERCISE. The Option may, but need not, include a provision whereby the Optionholder may elect at any time before the Optionholder's Continuous Service terminates to exercise the Option as to any part or all of the shares of Common Stock subject to the Option prior to the full vesting of the Option. Any unvested shares of Common Stock so purchased may be subject to a repurchase option in favor of the Company or to any other restriction the Board determines to be appropriate. The Company will not exercise its repurchase option until at least six (6) months (or such longer or shorter period of time required to avoid a charge to earnings for financial accounting purposes) have elapsed following exercise of the Option unless the Board otherwise specifically provides in the Option.

#### 7. PROVISIONS OF STOCK AWARDS OTHER THAN OPTIONS.

(a) STOCK BONUS AWARDS. Each stock bonus agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. The terms and conditions of stock bonus agreements may change from time to time, and the terms and conditions of separate stock bonus agreements need not be identical, but each stock bonus agreement shall include (through incorporation of provisions hereof by reference in the agreement or otherwise) the substance of each of the following provisions:

(i) CONSIDERATION. A stock bonus may be awarded in consideration for past services actually rendered to the Company or an Affiliate for its benefit.

(ii) VESTING. Shares of Common Stock awarded under the stock bonus agreement may, but need not, be subject to a share repurchase option in favor of the Company in accordance with a vesting schedule to be determined by the Board.

(iii) TERMINATION OF PARTICIPANT'S CONTINUOUS SERVICE. In the event that a Participant's Continuous Service terminates, the Company may reacquire any or all of the shares of Common Stock held by the Participant that have not vested as of the date of termination under the terms of the stock bonus agreement. The Company will not exercise its repurchase option until at least six (6) months (or such longer or shorter period of time required to avoid a charge to earnings for financial accounting purposes) have elapsed following receipt of the stock bonus unless otherwise specifically provided in the stock bonus agreement.

(iv) TRANSFERABILITY. Rights to acquire shares of Common Stock under the stock bonus agreement shall be transferable by the Participant only upon such terms and conditions as are set forth in the stock bonus agreement, as the Board shall determine in its

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discretion, so long as Common Stock awarded under the stock bonus agreement remains subject to the terms of the stock bonus agreement.

(b) RESTRICTED STOCK AWARDS. Each restricted stock purchase agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. The terms and conditions of the restricted stock purchase agreements may change from time to time, and the terms and conditions of separate restricted stock purchase agreements need not be identical, but each restricted stock purchase agreement shall include (through incorporation of provisions hereof by reference in the agreement or otherwise) the substance of each of the following provisions:

(i) PURCHASE PRICE. The purchase price of restricted stock awards shall not be less than eighty-five percent (85%) of the Common Stock's Fair Market Value on the date such award is made or at the time the purchase is consummated.

(ii) CONSIDERATION. The purchase price of Common Stock acquired pursuant to the restricted stock purchase agreement shall be paid either: (i) in

cash at the time of purchase; (ii) at the discretion of the Board, according to a deferred payment or other similar arrangement with the Participant; or (iii) in any other form of legal consideration that may be acceptable to the Board in its discretion; provided, however, that to the extent applicable state corporate laws so require, payment of the Common Stock's "par value," as defined by applicable state statutes, shall be made in cash and not by deferred payment.

(iii) VESTING. Shares of Common Stock acquired under the restricted stock purchase agreement may, but need not, be subject to a share repurchase option in favor of the Company in accordance with a vesting schedule to be determined by the Board.

(iv) TERMINATION OF PARTICIPANT'S CONTINUOUS SERVICE. In the event that a Participant's Continuous Service terminates, the Company may repurchase or otherwise reacquire any or all of the shares of Common Stock held by the Participant that have not vested as of the date of termination under the terms of the restricted stock purchase agreement. The Company will not exercise its repurchase option until at least six (6) months (or such longer or shorter period of time required to avoid a charge to earnings for financial accounting purposes) have elapsed following the purchase of the restricted stock unless otherwise provided in the restricted stock purchase agreement.

(v) TRANSFERABILITY. Rights to acquire shares of Common Stock under the restricted stock purchase agreement shall be transferable by the Participant only upon such terms and conditions as are set forth in the restricted stock purchase agreement, as the Board shall determine in its discretion, so long as Common Stock awarded under the restricted stock purchase agreement remains subject to the terms of the restricted stock purchase agreement.

#### 8. COVENANTS OF THE COMPANY.

(a) AVAILABILITY OF SHARES. During the terms of the Stock Awards, the Company shall keep available at all times the number of shares of Common Stock required to satisfy such Stock Awards.

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(b) SECURITIES LAW COMPLIANCE. The Company shall seek to obtain from each regulatory commission or agency having jurisdiction over the Plan such authority as may be required to grant Stock Awards and to issue and sell shares of Common Stock upon exercise of the Stock Awards; provided, however, that this undertaking shall not require the Company to register under the Securities Act the Plan, any Stock Award or any Common Stock issued or issuable pursuant to any such Stock Award. If, after reasonable efforts, the Company is unable to obtain from any such regulatory commission or agency the authority which counsel for the Company deems necessary for the lawful issuance and sale of Common Stock under the Plan, the Company shall be relieved from any liability for failure to issue and sell Common Stock upon exercise of such Stock Awards unless and until such authority is obtained.

#### 9. USE OF PROCEEDS FROM STOCK.

Proceeds from the sale of Common Stock pursuant to Stock Awards shall constitute general funds of the Company.

#### 10. MISCELLANEOUS.

(a) ACCELERATION OF EXERCISABILITY AND VESTING. The Board shall have the power to accelerate the time at which a Stock Award may first be exercised or the time during which a Stock Award or any part thereof will vest in accordance with the Plan, notwithstanding the provisions in the Stock Award stating the time at which it may first be exercised or the time during which it will vest.

(b) STOCKHOLDER RIGHTS. No Participant shall be deemed to be the holder of, or to have any of the rights of a holder with respect to, any shares of Common Stock subject to such Stock Award unless and until such Participant has satisfied all requirements for exercise of the Stock Award pursuant to its terms.

(c) NO EMPLOYMENT OR OTHER SERVICE RIGHTS. Nothing in the Plan or any instrument executed or Stock Award granted pursuant thereto shall confer upon any Participant any right to continue to serve the Company or an Affiliate in the capacity in effect at the time the Stock Award was granted or shall affect the right of the Company or an Affiliate to terminate (i) the employment of an Employee with or without notice and with or without cause, (ii) the service of a Consultant pursuant to the terms of such Consultant's agreement with the Company or an Affiliate or (iii) the service of a Director pursuant to the Bylaws of the Company or an Affiliate, and any applicable provisions of the corporate law of the state in which the Company or the Affiliate is incorporated, as the case may be.

(d) INCENTIVE STOCK OPTION \$100,000 LIMITATION. To the extent that the aggregate Fair Market Value (determined at the time of grant) of Common Stock with respect to which Incentive Stock Options are exercisable for the first time by any Optionholder during any calendar year (under all plans of the Company and its Affiliates) exceeds one hundred thousand dollars (\$100,000), the Options or portions thereof that exceed such limit (according to the order in which they were granted) shall be treated as Nonstatutory Stock Options, notwithstanding any contrary provision of a Stock Award Agreement.

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(e) INVESTMENT ASSURANCES. The Company may require a Participant, as a condition of exercising or acquiring Common Stock under any Stock Award, (i) to give written assurances satisfactory to the Company as to the Participant's knowledge and experience in financial and business matters and/or to employ a purchaser representative reasonably satisfactory to the Company who is knowledgeable and experienced in financial and business matters and that he or she is capable of evaluating, alone or together with the purchaser representative, the merits and risks of exercising the Stock Award; and (ii) to give written assurances satisfactory to the Company stating that the Participant is acquiring Common Stock subject to the Stock Award for the Participant's own account and not with any present intention of selling or otherwise distributing the Common Stock. The foregoing requirements, and any assurances given pursuant to such requirements, shall be inoperative if (1) the issuance of the shares of Common Stock upon the exercise or acquisition of Common Stock under the Stock Award has been registered under a then currently effective registration statement under the Securities Act or (2) as to any particular requirement, a determination is made by counsel for the Company that such requirement need not be met in the circumstances under the then applicable securities laws. The Company may, upon advice of counsel to the Company, place legends on stock certificates issued under the Plan as such counsel deems necessary or appropriate in order to comply with applicable securities laws, including, but not limited to, legends restricting the transfer of the Common Stock.

(f) WITHHOLDING OBLIGATIONS. To the extent provided by the terms of a Stock Award Agreement, the Participant may satisfy any federal, state or local tax withholding obligation relating to the exercise or acquisition of Common Stock under a Stock Award by any of the following means (in addition to the Company's right to withhold from any compensation paid to the Participant by the Company) or by a combination of such means: (i) tendering a cash payment; (ii) authorizing the Company to withhold shares of Common Stock from the shares of Common Stock otherwise issuable to the Participant as a result of the exercise or acquisition of Common Stock under the Stock Award; provided, however, that no shares of Common Stock are withheld with a value exceeding the minimum amount of tax required to be withheld by law (or such lesser amount as may be necessary to avoid variable award accounting); or (iii) delivering to the Company owned and unencumbered shares of Common Stock.

11. ADJUSTMENTS UPON CHANGES IN STOCK.

(a) CAPITALIZATION ADJUSTMENTS. If any change is made in, or other event occurs with respect to, the Common Stock subject to the Plan or subject to any Stock Award without the receipt of consideration by the Company (through merger, consolidation, reorganization, recapitalization, reincorporation, stock dividend, dividend in property other than cash, stock split, liquidating dividend, combination of shares, exchange of shares, change in corporate structure or other transaction not involving the receipt of consideration by the Company (each a "Capitalization Adjustment"), the Plan will be appropriately adjusted in the class(es) and maximum number of securities subject to the Plan pursuant to Sections 4(a) and 4(b) and the maximum number of securities subject to award to any person pursuant to Section 5(c), and the outstanding Stock Awards will be appropriately adjusted in the class(es) and number of securities and price per share of Common Stock subject to such outstanding Stock Awards. The Board shall make such adjustments, and its determination shall be final, binding and conclusive.

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(The conversion of any convertible securities of the Company shall not be treated as a transaction "without receipt of consideration" by the Company.)

(b) DISSOLUTION OR LIQUIDATION. In the event of a dissolution or liquidation of the Company, then all outstanding Options shall terminate immediately prior to the completion of such dissolution or liquidation, and shares of Common Stock subject to the Company's repurchase option may be repurchased by the Company notwithstanding the fact that the holder of such stock is still in Continuous Service.

(c) CORPORATE TRANSACTION. In the event of a Corporate Transaction, any surviving corporation or acquiring corporation may assume or continue any or all Stock Awards outstanding under the Plan or may substitute similar stock

awards for Stock Awards outstanding under the Plan (it being understood that similar stock awards include, but are not limited to, awards to acquire the same consideration paid to the stockholders or the Company, as the case may be, pursuant to the Corporate Transaction), and any reacquisition or repurchase rights held by the Company in respect of Common Stock issued pursuant to Stock Awards may be assigned by the Company to the successor of the Company (or the successor's parent company), if any, in connection with such Corporate Transaction. In the event that any surviving corporation or acquiring corporation does not assume or continue any or all such outstanding Stock Awards or substitute similar stock awards for such outstanding Stock Awards, then with respect to Stock Awards that have not been assumed, continued or substituted and that are held by Participants whose Continuous Service has not terminated prior to the effective time of the Corporate Transaction, the vesting of such Stock Awards (and, if applicable, the time at which such Stock Awards may be exercised) shall (contingent upon the effectiveness of the Corporate Transaction) be accelerated in full to a date prior to the effective time of such Corporate Transaction as the Board shall determine (or, if the Board shall not determine such a date, to the date that is five (5) days prior to the effective time of the Corporate Transaction), the Stock Awards shall terminate if not exercised (if applicable) at or prior to such effective time, and any reacquisition or repurchase rights held by the Company with respect to such Stock Awards held by Participants whose Continuous Service has not terminated shall (contingent upon the effectiveness of the Corporate Transaction) lapse. With respect to any other Stock Awards outstanding under the Plan that have not been assumed, continued or substituted, the vesting of such Stock Awards (and, if applicable, the time at which such Stock Award may be exercised) shall not be accelerated, unless otherwise provided in a written agreement between the Company or any Affiliate and the holder of such Stock Award, and such Stock Awards shall terminate if not exercised (if applicable) prior to the effective time of the Corporate Transaction.

(d) CHANGE IN CONTROL. A Stock Award held by any Participant whose Continuous Service has not terminated prior to the effective time of a Change in Control may be subject to additional acceleration of vesting and exercisability upon or after such event as may be provided in the Stock Award Agreement for such Stock Award or as may be provided in any other written agreement between the Company or any Affiliate and the Participant, but in the absence of such provision, no such acceleration shall occur.

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12. AMENDMENT OF THE PLAN AND STOCK AWARDS.

(a) AMENDMENT OF PLAN. The Board at any time, and from time to time, may amend the Plan. However, except as provided in Section 11(a) relating to Capitalization Adjustments, no amendment shall be effective unless approved by the stockholders of the Company to the extent stockholder approval is necessary to satisfy the requirements of Section 422 of the Code.

(b) STOCKHOLDER APPROVAL. The Board, in its sole discretion, may submit any other amendment to the Plan for stockholder approval, including, but not limited to, amendments to the Plan intended to satisfy the requirements of Section 162(m) of the Code and the regulations thereunder regarding the exclusion of performance-based compensation from the limit on corporate deductibility of compensation paid to Covered Employees.

(c) CONTEMPLATED AMENDMENTS. It is expressly contemplated that the Board may amend the Plan in any respect the Board deems necessary or advisable to provide eligible Employees with the maximum benefits provided or to be provided under the provisions of the Code and the regulations promulgated thereunder relating to Incentive Stock Options and/or to bring the Plan and/or Incentive Stock Options granted under it into compliance therewith.

(d) NO IMPAIRMENT OF RIGHTS. Rights under any Stock Award granted before amendment of the Plan shall not be impaired by any amendment of the Plan unless (i) the Company requests the consent of the Participant and (ii) the Participant consents in writing.

(e) AMENDMENT OF STOCK AWARDS. The Board at any time, and from time to time, may amend the terms of any one or more Stock Awards; provided, however, that the rights under any Stock Award shall not be impaired by any such amendment unless (i) the Company requests the consent of the Participant and (ii) the Participant consents in writing.

13. TERMINATION OR SUSPENSION OF THE PLAN.

(a) PLAN TERM. The Board may suspend or terminate the Plan at any time. Unless sooner terminated, the Plan shall terminate on the day before the tenth (10th) anniversary of the date the Plan is adopted by the Board or approved by the stockholders of the Company, whichever is earlier. No Stock Awards may be granted under the Plan while the Plan is suspended or after it is terminated.

(b) NO IMPAIRMENT OF RIGHTS. Suspension or termination of the Plan shall not impair rights and obligations under any Stock Award granted while the Plan is in effect except with the written consent of the Participant.

14. EFFECTIVE DATE OF PLAN.

The Plan shall become effective as determined by the Board, but no Stock Award shall be exercised (or, in the case of a stock bonus, shall be granted) unless and until the Plan has been approved by the stockholders of the Company, which approval shall be within twelve (12) months before or after the date the Plan is adopted by the Board.

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15. CHOICE OF LAW.

The law of the State of Maryland shall govern all questions concerning the construction, validity and interpretation of this Plan, without regard to such state's conflict of laws rules.

\* \* \* \*

List of Attachments

Attachment I: Form of Stock Option Agreement  
Attachment II: Form of Grant Notice  
Attachment III: Form of Notice of Exercise

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Attachment I

Form of Stock Option Agreement

AWARD NO. \_\_\_\_\_  
NAME: \_\_\_\_\_

GLADSTONE COMMERCIAL CORPORATION  
2003 EQUITY INCENTIVE PLAN

STOCK OPTION AGREEMENT  
(INCENTIVE STOCK OPTION OR NONSTATUTORY STOCK OPTION)

Pursuant to your Stock Option Grant Notice ("GRANT NOTICE") and this Stock Option Agreement, Gladstone Commercial Corporation ("COMPANY") has granted you an option under its 2003 Equity Incentive Plan ("PLAN") to purchase the number of shares of the Company's Common Stock indicated in your Grant Notice at the exercise price indicated in your Grant Notice. Defined terms not explicitly defined in this Stock Option Agreement but defined in the Plan shall have the same definitions as in the Plan.

The details of your option are as follows:

1. VESTING. Subject to the limitations contained herein, your option will vest as provided in your Grant Notice, provided that vesting will cease upon the termination of your Continuous Service.
2. NUMBER OF SHARES AND EXERCISE PRICE. The number of shares of Common Stock subject to your option and your exercise price per share referenced in your Grant Notice may be adjusted from time to time for Capitalization Adjustments.
3. EXERCISE PRIOR TO VESTING ("EARLY EXERCISE"). If permitted in your Grant Notice (i.e., the "Exercise Schedule" indicates that "Early Exercise" of your option is permitted) and subject to the provisions of your option, you may elect at any time that is both (i) during the period of your Continuous Service and (ii) during the term of your option, to exercise all or part of your

option, including the nonvested portion of your option; provided, however, that:

- a. a partial exercise of your option shall be deemed to cover first vested shares of Common Stock and then the earliest vesting installment of unvested shares of Common Stock;
- b. any shares of Common Stock so purchased from installments that have not vested as of the date of exercise shall be subject to the purchase option in favor of the Company as described in the Company's form of Early Exercise Stock Purchase Agreement;
- c. you shall enter into the Company's form of Early Exercise Stock Purchase Agreement with a vesting schedule that will result in the same vesting as if no early exercise had occurred; and

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- d. if your option is an Incentive Stock Option, then, to the extent that the aggregate Fair Market Value (determined at the time of grant) of the shares of Common Stock with respect to which your option plus all other Incentive Stock Options you hold are exercisable for the first time by you during any calendar year (under all plans of the Company and its Affiliates) exceeds one hundred thousand dollars (\$100,000), your option(s) or portions thereof that exceed such limit (according to the order in which they were granted) shall be treated as Nonstatutory Stock Options.

4. METHOD OF PAYMENT. Payment of the exercise price is due in full upon exercise of all or any part of your option. You may elect to make payment of the exercise price in cash or by check or in any other manner PERMITTED BY YOUR GRANT NOTICE, which may include one or more of the following:

- a. In the Company's sole discretion at the time your option is exercised and provided that at the time of exercise the Common Stock is publicly traded and quoted regularly in The Wall Street Journal, pursuant to a program developed under Regulation T as promulgated by the Federal Reserve Board that, prior to the issuance of Common Stock, results in either the receipt of cash (or check) by the Company or the receipt of irrevocable instructions to pay the aggregate exercise price to the Company from the sales proceeds.
- b. Provided that at the time of exercise the Common Stock is publicly traded and quoted regularly in The Wall Street Journal, by delivery of already-owned shares of Common Stock either that you have held for the period required to avoid a charge to the Company's reported earnings (generally six (6) months) or that you did not acquire, directly or indirectly from the Company, that are owned free and clear of any liens, claims, encumbrances or security interests, and that are valued at Fair Market Value on the date of exercise. "Delivery" for these purposes, in the sole discretion of the Company at the time you exercise your option, shall include delivery to the Company of your attestation of ownership of such shares of Common Stock in a form approved by the Company. Notwithstanding the foregoing, you may not exercise your option by tender to the Company of Common Stock to the extent such tender would violate the provisions of any law, regulation or agreement restricting the redemption of the Company's stock.
- c. Pursuant to the following deferred payment alternative:
  - 1) Not less than one hundred percent (100%) of the aggregate exercise price, plus accrued interest, shall be due four (4) years from date of exercise or, at the Company's election, upon termination of your Continuous Service.

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- 2) Interest shall be compounded at least annually and shall be charged at the minimum rate of interest necessary to avoid (1) the treatment as interest, under any applicable provisions of the Code, of any



amounts other than amounts stated to be interest under the deferred payment arrangement and (2) the treatment of the Option as a variable award for financial accounting purposes.

- 3) If so required by applicable state corporate law, payment of the Common Stock's "par value," as defined in the applicable corporate statute, shall be made in cash and not by deferred payment.
- 4) In order to elect the deferred payment alternative, you must, as a part of your written notice of exercise, give notice of the election of this payment alternative and, in order to secure the payment of the deferred exercise price to the Company hereunder, if the Company so requests, you must tender to the Company a promissory note and a pledge agreement covering the purchased shares of Common Stock, both in form and substance satisfactory to the Company, or such other or additional documentation as the Company may request.
5. WHOLE SHARES. You may exercise your option only for whole shares of Common Stock.
6. SECURITIES LAW COMPLIANCE. Notwithstanding anything to the contrary contained herein, you may not exercise your option unless the shares of Common Stock issuable upon such exercise are then registered under the Securities Act or, if such shares of Common Stock are not then so registered, the Company has determined that such exercise and issuance would be exempt from the registration requirements of the Securities Act. The exercise of your option also must comply with other applicable laws and regulations governing your option, and you may not exercise your option if the Company determines that such exercise would not be in material compliance with such laws and regulations.
7. TERM. You may not exercise your option before the commencement or after the expiration of its term. Subject to such differing terms that may be included in an individually negotiated written agreement between you and the Company, the term of your option commences on the Date of Grant and expires upon the earliest of the following:
  - A. three (3) months after the termination of your Continuous Service for any reason other than your Disability or death, provided that if during any part of such three (3) month period your option is not exercisable solely because of the condition set forth in Section 6, your option shall not expire until the earlier of the Expiration Date or until it shall have been

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exercisable for an aggregate period of three (3) months after the termination of your Continuous Service;

- b. twelve (12) months after the termination of your Continuous Service due to your Disability;
- c. eighteen (18) months after your death if you die either during your Continuous Service or within three (3) months after your Continuous Service terminates;
- d. the Expiration Date indicated in your Grant Notice; or
- e. the day before the tenth (10th) anniversary of the Date of Grant.

If your option is an Incentive Stock Option, note that to obtain the federal income tax advantages associated with an Incentive Stock Option, the Code requires that at all times beginning on the date of grant of your option and ending on the day three (3) months before the date of your option's exercise, you must be an employee of the Company or an Affiliate, except in the event of your death or Disability. The Company has provided for extended exercisability of your option under certain circumstances for your benefit but cannot guarantee that your option will necessarily be treated as an Incentive Stock Option if you continue to provide services to the Company or an Affiliate as a Consultant or Director after your employment terminates or if you otherwise exercise your option more than three (3) months after the date your employment with the Company or an Affiliate terminates.

8. EXERCISE.

- a. You may exercise the vested portion of your option (and the unvested portion of your option if your Grant Notice so permits) during its term by delivering a Notice of Exercise (in a form designated by the Company) together with the exercise price to the Secretary of the Company, or to such other person as the Company may designate, during regular business hours, together with such additional documents as the Company may then require.
- b. By exercising your option you agree that, as a condition to any exercise of your option, the Company may require you to enter into an arrangement providing for the payment by you to the Company of any tax withholding obligation of the Company arising by reason of (1) the exercise of your option, (2) the lapse of any substantial risk of forfeiture to which the shares of Common Stock are subject at the time of exercise, or (3) the disposition of shares of Common Stock acquired upon such exercise.
- c. If your option is an Incentive Stock Option, by exercising your option you agree that you will notify the Company in writing within fifteen (15) days after the date of any disposition of any of the shares of the Common Stock issued upon exercise of your option that occurs within two (2) years after

4.

the date of your option grant or within one (1) year after such shares of Common Stock are transferred upon exercise of your option.

- d. By exercising your option you agree that you shall not sell, dispose of, transfer, make any short sale of, grant any option for the purchase of, or enter into any hedging or similar transaction with the same economic effect as a sale, any shares of Common Stock or other securities of the Company held by you, for a period of time specified by the managing underwriter(s) (not to exceed one hundred eighty (180) days) following the effective date of a registration statement of the Company filed under the Securities Act ("LOCK UP PERIOD"); provided, however, that nothing contained in this section shall prevent the exercise of a repurchase option, if any, in favor of the Company during the Lock Up Period. You further agree to execute and deliver such other agreements as may be reasonably requested by the Company and/or the underwriter(s) that are consistent with the foregoing or that are necessary to give further effect thereto. In order to enforce the foregoing covenant, the Company may impose stop-transfer instructions with respect to your shares of Common Stock until the end of such period. The underwriters of the Company's stock are intended third party beneficiaries of this Section 8(d) and shall have the right, power and authority to enforce the provisions hereof as though they were a party hereto.
9. TRANSFERABILITY. Your option is not transferable, except by will or by the laws of descent and distribution, and is exercisable during your life only by you, except that if your option is a nonstatutory stock option, you may assign or grant your option to a trust, individual retirement account or pension plan for your benefit. Notwithstanding the foregoing, by delivering written notice to the Company, in a form satisfactory to the Company, you may designate a third party who, in the event of your death, shall thereafter be entitled to exercise your option.
10. OPTION NOT A SERVICE CONTRACT. Your option is not an employment or service contract, and nothing in your option shall be deemed to create in any way whatsoever any obligation on your part to continue in the employ of the Company or an Affiliate, or of the Company or an Affiliate to continue your employment. In addition, nothing in your option shall obligate the Company or an Affiliate, their respective stockholders, Boards of Directors, Officers or Employees to continue any relationship that you might have as a Director or Consultant for the Company or an Affiliate.
11. WITHHOLDING OBLIGATIONS.
- a. At the time you exercise your option, in whole or in part,

or at any time thereafter as requested by the Company, you hereby authorize withholding from payroll and any other amounts payable to you, and otherwise agree to make adequate provision for (including by means of a "cashless exercise" pursuant to a program developed under Regulation T as promulgated by the Federal Reserve Board to the extent permitted by the Company), any sums required to satisfy the federal, state, local and

5.

foreign tax withholding obligations of the Company or an Affiliate, if any, which arise in connection with the exercise of your option.

- b. Upon your request and subject to approval by the Company, in its sole discretion, and compliance with any applicable legal conditions or restrictions, the Company may withhold from fully vested shares of Common Stock otherwise issuable to you upon the exercise of your option a number of whole shares of Common Stock having a Fair Market Value, determined by the Company as of the date of exercise, not in excess of the minimum amount of tax required to be withheld by law (or such lower amount as may be necessary to avoid variable award accounting). If the date of determination of any tax withholding obligation is deferred to a date later than the date of exercise of your option, share withholding pursuant to the preceding sentence shall not be permitted unless you make a proper and timely election under Section 83(b) of the Code, covering the aggregate number of shares of Common Stock acquired upon such exercise with respect to which such determination is otherwise deferred, to accelerate the determination of such tax withholding obligation to the date of exercise of your option. Notwithstanding the filing of such election, shares of Common Stock shall be withheld solely from fully vested shares of Common Stock determined as of the date of exercise of your option that are otherwise issuable to you upon such exercise. Any adverse consequences to you arising in connection with such share withholding procedure shall be your sole responsibility.
- c. You may not exercise your option unless the tax withholding obligations of the Company and/or any Affiliate are satisfied. Accordingly, you may not be able to exercise your option when desired even though your option is vested, and the Company shall have no obligation to issue a certificate for such shares of Common Stock or release such shares of Common Stock from any escrow provided for herein unless such obligations are satisfied.

12. NOTICES. Any notices provided for in your option or the Plan shall be given in writing and shall be deemed effectively given upon receipt or, in the case of notices delivered by mail by the Company to you, five (5) days after deposit in the United States mail, postage prepaid, addressed to you at the last address you provided to the Company.

13. GOVERNING PLAN DOCUMENT. Your option is subject to all the provisions of the Plan, the provisions of which are hereby made a part of your option, and is further subject to all interpretations, amendments, rules and regulations, which may from time to time be promulgated and adopted pursuant to the Plan. In the event of any conflict between the provisions of your option and those of the Plan, the provisions of the Plan shall control.

\* \* \* \* \*

6.

Attachment II  
Form of Grant Notice

Award No. \_\_\_\_\_

NAME: \_\_\_\_\_

STOCK OPTION GRANT NOTICE  
 (2003 EQUITY INCENTIVE PLAN)

Gladstone Commercial Corporation (the "Company"), pursuant to its 2003 Equity Incentive Plan (the "Plan"), hereby grants to Optionholder an option to purchase the number of shares of the Company's Common Stock set forth below. This option is subject to all of the terms and conditions as set forth herein and in the Stock Option Agreement, the Plan and the Notice of Exercise, all of which are attached hereto and incorporated herein in their entirety.

Optionholder: \_\_\_\_\_  
 Date of Grant: \_\_\_\_\_  
 Vesting Commencement Date: \_\_\_\_\_  
 Number of Shares Subject to Option: \_\_\_\_\_  
 Exercise Price (Per Share): \_\_\_\_\_  
 Total Exercise Price: \_\_\_\_\_  
 Expiration Date: \_\_\_\_\_

TYPE OF GRANT:  Incentive Stock Option(1)  Nonstatutory Stock Option

EXERCISE SCHEDULE:  Same as Vesting Schedule  Early Exercise Permitted

VESTING SCHEDULE: [TO BE ADDED]

PAYMENT: By one or a combination of the following items (described in the Stock Option Agreement):

- By cash or check
- Pursuant to a Regulation T Program if the Shares are publicly traded
- By delivery of already-owned shares if the Shares are publicly traded

ADDITIONAL TERMS/ACKNOWLEDGEMENTS: The undersigned Optionholder acknowledges receipt of, and understands and agrees to, this Grant Notice, the Stock Option Agreement and the Plan. Optionholder further acknowledges that as of the Date of Grant, this Grant Notice, the Stock Option Agreement and the Plan set forth the entire understanding between Optionholder and the Company regarding the acquisition of stock in the Company and supersede all prior oral and written agreements on that subject with the exception of (i) options previously granted and delivered to Optionholder under the Plan, and (ii) the following agreements only:

OTHER AGREEMENTS: \_\_\_\_\_  
 \_\_\_\_\_

GLADSTONE COMMERCIAL CORPORATION

OPTIONHOLDER:

By: \_\_\_\_\_  
                                 Signature  Signature

Title: \_\_\_\_\_ Date: \_\_\_\_\_

Date: \_\_\_\_\_

ATTACHMENTS: Stock Option Agreement, 2003 Equity Incentive Plan and Notice of Exercise

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(1) If this is an incentive stock option, it (plus your other outstanding incentive stock options) cannot be first exercisable for more than \$100,000 in any calendar year. Any excess over \$100,000 is a nonstatutory stock option.

NOTICE OF EXERCISE

Gladstone Commercial Corporation
1750 Tysons Blvd.
Fourth Floor
McLean, VA 22102

Date of Exercise: \_\_\_\_\_

Ladies and Gentlemen:

This constitutes notice under my stock option that I elect to purchase the number of shares for the price set forth below.

Type of option (check one): Incentive |\_| Nonstatutory |\_|

Stock option dated: \_\_\_\_\_

Number of shares as to which option is exercised: \_\_\_\_\_

Certificates to be issued in name of: \_\_\_\_\_

Total exercise price: \$ \_\_\_\_\_

Cash payment delivered herewith: \$ \_\_\_\_\_

Promissory Note delivered herewith: \$ \_\_\_\_\_

Value of \_\_\_\_\_ shares of Gladstone Commercial Corporation stock delivered herewith(2): \$ \_\_\_\_\_

By this exercise, I agree (i) to provide such additional documents as you may require pursuant to the terms of the 2003 Equity Incentive Plan, (ii) to provide for the payment by me to you (in the manner designated by you) of your withholding obligation, if any, relating to the exercise of this option, and (iii) if this exercise relates to an incentive stock option, to notify you in writing within fifteen (15) days after the date of any disposition of any of the shares of Common Stock issued upon exercise of this option that occurs within two (2) years after the date

(2) Shares must meet the public trading requirements set forth in the option. Shares must be valued in accordance with the terms of the option being exercised, must have been owned for the minimum period required in the option, and must be owned free and clear of any liens, claims, encumbrances or security interests. Certificates must be endorsed or accompanied by an executed assignment separate from certificate.

of grant of this option or within one (1) year after such shares of Common Stock are issued upon exercise of this option.

I hereby make the following certifications and representations with respect to the number of shares of Common Stock of the Company listed above (the "Shares"), which are being acquired by me for my own account upon exercise of the Option as set forth above:

[I acknowledge that the Shares have not been registered under the Securities Act of 1933, as amended (the "Securities Act"), and are deemed to constitute "restricted securities" and "control securities" under Rule 144 promulgated under the Securities Act. I warrant and represent to the Company that I have no present intention of distributing or selling said Shares, except as permitted under the Securities Act and any applicable state securities laws.]

I further acknowledge that all certificates representing any of the Shares subject to the provisions of the Option shall have endorsed thereon appropriate legends reflecting the foregoing limitations, as well as any legends reflecting restrictions pursuant to the Company's Articles of Incorporation, Bylaws and/or applicable securities laws.

Very truly yours,

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CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the use in this Registration Statement on Form S-11 of our report dated June 10, 2003 relating to the financial statements of Gladstone Commercial Corporation, which appear in such Registration Statement. We also consent to the reference to us under the heading "Experts".

/s/ PricewaterhouseCoopers LLP

New York, NY  
June 11, 2003

DAVID A.R. DULLUM

June 10, 2003

Gladstone Commercial Corporation  
1750 Tysons Blvd., 4th Floor  
McLean, Virginia 22102

CONSENT TO REFERENCE IN PROSPECTUS

In connection with the Registration Statement on Form S-11 filed by Gladstone Commercial Corporation (the "COMPANY"), File No. 333-\_\_\_\_\_, I hereby consent to the reference to me in the prospectus included in such registration statement as having agreed to join the board of directors of the Company.

Very truly yours,

/s/ David A.R. Dullum

David A.R. Dullum

MICHELA A. ENGLISH

June 11, 2003

Gladstone Commercial Corporation  
1750 Tysons Blvd., 4th Floor  
McLean, Virginia 22102

CONSENT TO REFERENCE IN PROSPECTUS

In connection with the Registration Statement on Form S-11 filed by Gladstone Commercial Corporation (the "COMPANY"), File No. 333-\_\_\_\_\_, I hereby consent to the reference to me in the prospectus included in such registration statement as having agreed to join the board of directors of the Company.

Very truly yours,

/s/ Michela A. English

Michela A. English



ANTHONY W. PARKER

June 11, 2003

Gladstone Commercial Corporation  
1750 Tysons Blvd., 4th Floor  
McLean, Virginia 22102

CONSENT TO REFERENCE IN PROSPECTUS

In connection with the Registration Statement on Form S-11 filed by Gladstone Commercial Corporation (the "COMPANY"), File No. 333-\_\_\_\_\_, I hereby consent to the reference to me in the prospectus included in such registration statement as having agreed to join the board of directors of the Company.

Very truly yours,

/s/ Anthony W. Parker

Anthony W. Parker

PAUL W. ADELGREN

June 10, 2003

Gladstone Commercial Corporation  
1750 Tysons Blvd., 4th Floor  
McLean, Virginia 22102

CONSENT TO REFERENCE IN PROSPECTUS

In connection with the Registration Statement on Form S-11 filed by Gladstone Commercial Corporation (the "COMPANY"), File No. 333-\_\_\_\_\_, I hereby consent to the reference to me in the prospectus included in such registration statement as having agreed to join the board of directors of the Company.

Very truly yours,

/s/ Paul W. Adelgren

Paul W. Adelgren