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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**PRE-EFFECTIVE**

**AMENDMENT NO. 1**

**to**

**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**

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(3)
Common Stock, \$0.001 par value per share	6,325,000 shares	\$ 15.00	\$ 94,875,000	\$ 7,675.39

- (1) Includes 825,000 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.
- (3) In connection with the initial filing of this Registration Statement, the registrant paid a registration fee of \$6,310.20. The registrant has paid the additional amount of \$1,365.19 concurrently with the filing of this pre-effective amendment.

**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.**

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 July 22, 2003

## GLADSTONE COMMERCIAL CORPORATION



### 5,500,000 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 selectively 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 7 of this prospectus. Some risks include:**

- We are a new company with no operating history and may not be able to operate successfully.
- 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 are not currently able to set a distribution rate, and the distribution rate we fix in the future may have an adverse effect on the market price for our common stock.
- Conflicts of interest exist between us, our Adviser, its officers and directors and their affiliates, which could result in decisions that are not in the best interests of our stockholders.
- We have not identified any specific property to purchase or mortgage loan to make with the net proceeds we will receive from this offering. As a result, investors will be unable to evaluate the manner in which the net proceeds are invested and the economic merits of projects prior to investment.
- Highly leveraged tenants and borrowers may be unable to pay rent or make mortgage payments, which could adversely affect our cash available to make distributions to our stockholders.
- Our success will depend on the performance of our Adviser. If our Adviser makes inadvisable investment or management decisions, our operations could be materially adversely impacted.

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

The underwriters may also purchase up to an additional 825,000 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.

**Ferris, Baker Watts**  
Incorporated

**Jefferies & Company, Inc.**

**J.J.B. Hilliard, W.L. Lyons, Inc.**  
Incorporated

**Stifel, Nicolaus & Company,**

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

## 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 selectively making long-term industrial and commercial mortgage loans. We expect that a large portion of our tenants and borrowers will be small and medium-sized businesses having significant buyout fund ownership and will be well capitalized, with equity constituting between 20% and 40% of their permanent capital. We expect that other tenants and borrowers will be family-owned businesses that have built significant equity from paying down the mortgage loans securing their real estate or through the appreciation in the value of their real estate. Although we have not yet purchased any properties or made any mortgage loans, we are actively communicating with buyout funds, real estate brokers and other third parties to locate 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, through our wholly owned subsidiary Gladstone Commercial Partners, LLC, we 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 are owned 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 selectively 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 our stockholders in the form of quarterly cash distributions 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 occasionally make 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. Upon the completion of this offering, we expect to begin investing in the types of investments described above and may also invest in temporary investments. As a result, we expect to generate taxable income for the fiscal year ending December 31, 2003, and therefore we intend to make quarterly distributions to our stockholders beginning within 120 days after we complete this offering in order to qualify as a real estate investment trust for federal income tax purposes for the 2003 tax year.

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. 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, but we are not otherwise limited with respect to the amount of leverage that we may use for the acquisition of any specific property. We intend to use non-recourse 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 we have with our Adviser, 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. Our Adviser's address is 1750 Tysons Blvd., Fourth Floor, McLean, Virginia 22102, and its telephone number is (703) 744-1165.

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, or 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:

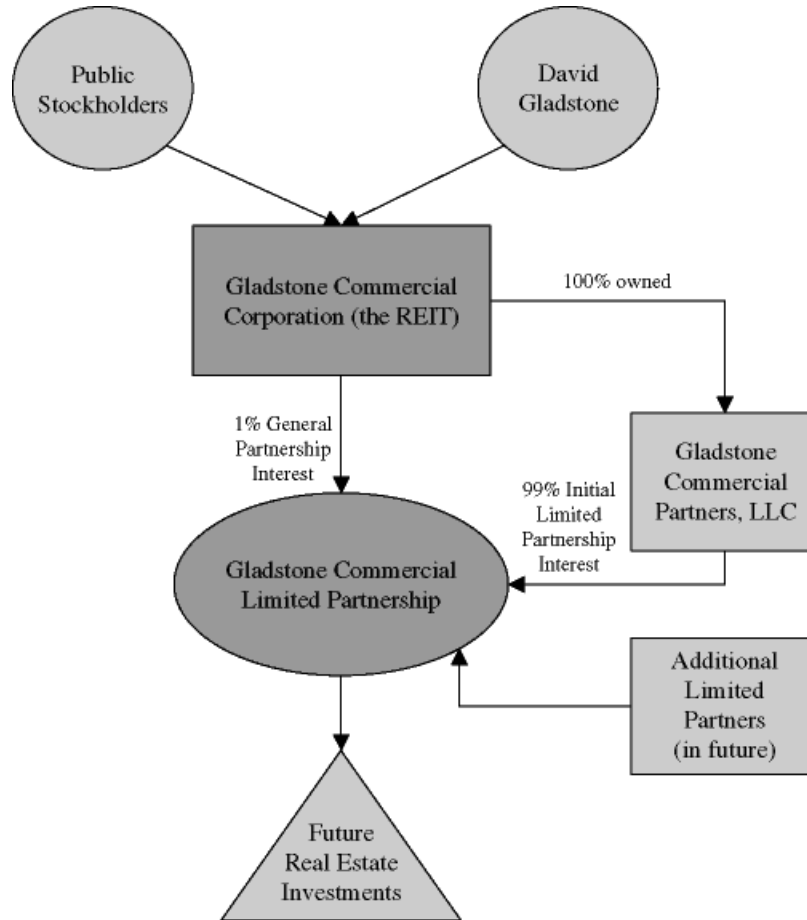
- reimbursement on a dollar-for-dollar basis for all expenses incurred by our Adviser for our direct benefit (for example, organizational and offering expenses, legal, accounting, tax and consulting fees);
- reimbursement on a dollar-for-dollar basis for all additional fees charged by third parties that 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 2.0% 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."

In rare circumstances, we may pay fees to our Adviser in addition to the reimbursement of expenses described above. Any such fees will be subject to the approval of our board of directors.

### Our Structure

The following diagram depicts our ownership structure upon completion of this offering. Our Operating Partnership will own our real estate investments directly or indirectly, and in some cases through special purpose entities that we may create in connection with the acquisition of real property.



## Risk Factors

You should carefully consider the matters discussed in the “Risk Factors” section of this prospectus beginning on page 7 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 mortgage loan to make with the net proceeds we will receive from this offering and, as a result, investors will be unable to evaluate the manner in which the net proceeds are invested and the economic merits of projects prior to investment.
- We are not currently able to set a distribution rate, and the distribution 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 mortgage payments, which could adversely affect our cash available to make distributions to our stockholders.
- 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 distributions, 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 if our Adviser makes inadvisable investment or management decisions, our operations could be materially adversely impacted.

## Our Affiliates

All but one of our directors and all of our 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 real estate lease or mortgage 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. We will obtain approval of our stockholders before we change our policy on co-investments with affiliates.

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 real estate lease or mortgage 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 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; 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)	5,500,000 shares
Common stock to be outstanding after this offering (1)	5,552,000 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 and timing of our distributions.
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 825,000 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 1,100,000 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. Any shares of our common stock not directed by us will be sold by the underwriters in the offering at the public offering price set forth on the cover of this prospectus. 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 the value of an investment in our common stock may decline substantially or be reduced to zero.

***We have not identified any specific property to purchase or mortgage loan to make with the net proceeds we will receive from this offering, and investors will be unable to evaluate the manner in which the net proceeds are invested and the economic merits of projects prior to investment.***

At the time of this offering, we have not identified any specific property to purchase or mortgage loan to make with the net proceeds we will receive from this offering. As a result, investors in the offering will be unable to evaluate the manner in which the net proceeds are invested and the economic merits of projects prior to investment. Additionally, our Adviser will have broad authority to make acquisitions of, or mortgage loans with respect to, properties that it may identify in the future. 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. We cannot assure you that acquisitions or mortgage loans made using the proceeds of this offering will produce a return on our investment. 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 distribution rate, and the distribution 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 to fix our distribution rate. Our distribution 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 distribution 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 mortgage payments, which could adversely affect our cash available to make distributions to our stockholders.***

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 mortgage 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 rent or make mortgage payments throughout the lease or loan

term. 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 mortgage payments to us;
- an increase in the costs we incur to carry the property occupied by such tenant;
- a reduction in the value of our 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 distributions, 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 distributions to our stockholders and may experience losses. We may borrow on a secured or unsecured basis. Neither our articles of incorporation nor our bylaws impose any limitation on borrowing on us. However, 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 will be affected by our ability to borrow money in sufficient amounts and on favorable terms. We expect that we will borrow money that will be secured by our properties and that these financing arrangements will contain customary covenants such as those that limit our ability, without the prior consent of the lender, to further mortgage the applicable property or to discontinue insurance coverage. 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.

Once the net proceeds of this offering have been substantially fully invested, we intend to acquire additional properties by borrowing all or a portion of the purchase price and securing the loan with a mortgage on some or all of our real property. If we are unable to make our debt payments as required, a lender could foreclose on the property securing its loan. This could cause us to lose part or all of our investment in such property which in turn could cause the value of our 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 for the acquisition of properties with many other entities engaged in real estate investment activities, including financial institutions, institutional pension funds, other REITs, other public and private real estate companies and private real estate investors. These competitors may prevent us from

acquiring desirable properties or may cause an increase in the price we must pay for real estate. Our competitors may have greater resources than we do, and may be willing to pay more for certain assets or may have a more compatible operating philosophy with our acquisition targets. In particular, larger REITs may enjoy significant competitive advantages that result from, among other things, a lower cost of capital and enhanced operating efficiencies. Our competitors may also adopt transaction structures similar to ours, which would decrease our competitive advantage in offering flexible transaction terms. In addition, the number of entities and the amount of funds competing for suitable investment properties may increase, resulting in increased demand and increased prices paid for these properties. 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 mortgage payments.* A small or medium-sized tenant or borrower is more likely to have difficulty making its lease or mortgage payments when it experiences adverse events, such as the failure to meet its business plan, a downturn in its industry or negative economic conditions.
- *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 experience significant fluctuations in their operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, may require substantial additional capital to support their operations, to finance expansion or to maintain their competitive positions, may otherwise have a weak financial position or may be adversely affected by changes in the business cycle. Our tenants and borrowers may not meet net income, cash flow and other coverage tests typically imposed by their senior lenders. The failure of a tenant or borrower to satisfy financial or operating covenants imposed by senior lenders could lead to defaults and, potentially, foreclosure on credit facilities, which could additionally trigger cross-defaults in other agreements. If this were to occur, it is possible that the ability of the tenant or borrower to make required payments to us would be jeopardized.
- *Small and medium-sized businesses are more likely to be dependent on one or two persons.* Typically, the success of a small or medium-sized business also depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of

one or more of these persons could have a material adverse impact on our tenant or borrower and, in turn, on us.

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

***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 rely on public and private debt and equity capital to fund our business. 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.***

Based on the anticipated net proceeds to be received from this offering, the expected investment size and our Adviser's experience in the marketplace, we estimate that we will purchase, or make mortgage loans secured by, an aggregate of approximately 10 to 15 properties with the proceeds of this offering. To the extent we are able to leverage such investments, we will acquire additional properties with the proceeds of borrowings, subject to our debt policy. 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. Even if we were to have 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.

***Failure to hedge effectively against interest rate changes may adversely affect our results of operations.***

We may experience interest rate volatility in connection with mortgage loans on our properties or other variable-rate debt that we may obtain from time to time. We may seek to mitigate our exposure to changing interest rates by using interest rate hedging arrangements such as interest rate swaps and caps. These derivative instruments involve risk and may not be effective in reducing our exposure to interest rate changes. Risks inherent in derivative instruments include the risk that counter-parties to derivative contracts may be unable to perform their obligations, the risk that interest rates move in a direction contrary to, or move slower than the period contemplated by, the direction or time period that the derivative instrument is designed to cover, and the risk that the terms of such instrument will not be legally enforceable. While we intend to design our hedging strategies to protect against movements in interest rates, derivative instruments that we are likely to use may also involve immediate costs, which could reduce our cash available for distribution to our stockholders. Likewise, ineffective hedges, as well as the occurrence of any of the risks inherent in derivatives, could adversely affect our reported operating results or reduce your overall investment returns. Our Adviser and our board of directors will review each of our derivative contracts and periodically evaluate their effectiveness against their stated purposes.

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

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

Our ability to achieve our investment objectives and to pay distributions to our stockholders is dependent upon the performance of our Adviser in evaluating potential investments, selecting and negotiating property purchases and dispositions and mortgage loans, selecting tenants and borrowers, setting lease or mortgage loan terms and determining financing arrangements. 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, most of 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 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; 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.

***We will not seek to obtain a ruling from the Internal Revenue Service (IRS) that we qualify as a REIT for federal income tax purposes.***

As described herein, we intend to operate so as to qualify as a REIT for federal income tax purposes. Although we have not requested, and do not expect to request, a ruling from the IRS that we qualify as a REIT, we have received an opinion of our counsel that, based on certain assumptions and representations, we will so qualify. You should be aware, however, that opinions of counsel are not binding on the IRS or any court. The REIT qualification opinion only represents the view of our counsel based on its review and analysis of existing law, which includes no controlling precedent, and therefore could be subject to modification or withdrawal based on future legislative, judicial or administrative changes to the federal income tax laws, any of which could be applied retroactively. The validity of the opinion of our counsel and of our qualification as a REIT will depend on our continuing ability to meet the various REIT requirements described herein. An IRS determination that we do not qualify as a REIT would deprive our stockholders of the tax benefits of our REIT status only if the IRS determination is upheld in court or otherwise becomes final. To the extent that we challenge an IRS determination that we do not qualify as a REIT, we may incur legal expenses that would reduce our funds available for distribution to stockholders.

***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.

***The IRS may treat sale-leaseback transactions as loans, which could jeopardize our REIT status.***

The IRS 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. If a sale-leaseback transaction were so recharacterized, we might fail to satisfy the asset or income tests required for REIT qualification 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 the distribution test for REIT qualification. See “Federal Income Tax Consequences of our Status as a REIT — Sale-Leaseback Transactions.”

***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.

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

We intend to maintain the status of the Operating Partnership as a partnership for federal income tax purposes. However, if the IRS were to successfully challenge the status of the Operating Partnership as a partnership, it would be taxable as a corporation. In such event, this would reduce the amount of distributions that the Operating Partnership could make to us. This would also result in our losing REIT status and becoming subject to a corporate level tax on our own income. This would substantially reduce our cash available to pay distributions and the return on your investment. In addition, if any of the entities through which the Operating Partnership owns its properties, in whole or in part, loses its characterization

as a partnership for federal income tax purposes, it would be subject to taxation as a corporation, thereby reducing distributions to the Operating Partnership. Such a recharacterization of an underlying property owner could also threaten our ability to maintain REIT status.

### **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 distributions;
- 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 759,000 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 economies. 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 make distributions 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 distribution rate as a percentage of our share price, relative to market interest rates. If market interest rates increase, prospective investors may desire a higher distribution 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 distribution rate, the market price of our common stock could decrease because potential investors may require a higher distribution 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 \$75.7 million (\$87.2 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 mortgage 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.

A tabular presentation of our estimated use of the proceeds of this offering (assuming no exercise of the underwriters’ over-allotment option) is set forth below:

	Dollar Amount (in thousands)	Percentage
Gross offering proceeds	\$ 82,500	100%
Underwriting discounts	5,775	7%
Other expenses of offering	1,000	1%
Estimated amount of net proceeds to us (to be used to acquire properties and for general corporate and working capital purposes)	\$ 75,725	92%

## DISTRIBUTION 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. Upon the completion of this offering, we expect to begin investing in the types of investments described in this prospectus, including temporary investments. As a result, we expect to generate taxable income for the fiscal year ending December 31, 2003, and therefore 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 June 30, 2003 on a historical basis and as adjusted to give effect to the sale of our common stock offered in this offering, net of the underwriting discount and \$1 million of estimated offering expenses, 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.

	<u>Actual</u>	<u>As adjusted</u>
		(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, 5,552,000 shares outstanding, as adjusted	\$ 52	\$ 5,552
Additional paid-in capital	51,948	75,771,448
Retained deficit	(10,654)	(10,654)
Total stockholders' equity (deficit)	<u>\$ 41,346</u>	<u>\$75,766,346</u>



## DILUTION

The calculations below 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 June 30, 2003 was \$41,346, 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 June 30, 2003 would have been approximately \$75.7 million or \$13.65 per share of common stock. This represents an immediate increase in net tangible book value of \$12.85 per share to existing stockholders and immediate dilution of \$1.35 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 June 30, 2003 as adjusted	\$ .80
Increase attributable to the sale of shares offered hereby	\$12.85
Adjusted net tangible book value after this offering	\$13.65
Dilution in the net tangible book value to new investors	\$ 1.35

The following table summarizes on a pro forma basis at June 30, 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 stockholder	52,000	0.94%	\$ 52,000	0.06%	\$ 1.00
New investors	5,500,000	99.06%	\$82,500,000	99.94%	\$ 15.00
Total	5,552,000	100%	\$82,552,000	100%	\$ 14.87

**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 selectively making long-term industrial and commercial mortgage loans. We expect that a large portion of our tenants and borrowers will be small and medium-sized businesses that have significant buyout fund ownership and will be well capitalized, with equity constituting between 20% and 40% of their permanent capital. We expect that other tenants and borrowers will be family-owned businesses that have built significant equity from paying down the mortgage loans securing their real estate or through the appreciation in the value of their real estate. Although we have not yet purchased any properties or made any mortgage loans, we are actively communicating with buyout funds, real estate brokers and other third parties to locate 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, which we refer to as our "Operating Partnership." We will control our Operating Partnership as its sole general partner, and, through our wholly owned subsidiary Gladstone Commercial Partners, LLC, we 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 distributions. 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. Under different conditions or assumptions, materially different amounts could be reported related to the accounting policies described below. In addition, application of these accounting policies involves the exercise of judgments on the use of assumptions as to future uncertainties and, as a result, actual results could materially differ from these estimates.

### ***Revenue Recognition***

Our revenues, which will be comprised largely of 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 establishes 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 a party to any derivatives contract.

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

Our accounting policies require that we reflect in our financial statements an allowance for estimated credit losses with respect to mortgage loans we have made based upon our evaluation of known and inherent risks associated with our private lending assets. While we have not yet made any mortgage loans and therefore have not experienced any actual losses in connection with our lending investments, management considers it prudent, once we have made mortgage 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 mortgage 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 \$75 million and no indebtedness. We believe that these cash resources will be sufficient to satisfy our cash requirements for the foreseeable future, and we do not anticipate a need to raise additional funds within the next twelve months.

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.

In addition to making investments in accordance with our investment policies, we will also use our capital resources to reimburse our Adviser for certain expenses that our Adviser incurs on our behalf pursuant to the terms of our advisory agreement. We will reimburse our Adviser for all expenses incurred by our Adviser for our direct benefit, such as organizational expenses, offering, legal, accounting, tax preparation, consulting and related fees. 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 following the offering. 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 aggregate amounts of mortgage 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 2.0% of our average invested assets for the 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. For additional information regarding the payments to be made to our Adviser, see "Our Adviser — Advisory Agreement — Payments to our Adviser under the Advisory Agreement."

Each of our officers is also an officer or director of our Adviser. As such, potential conflicts of interest exist as a result of our relationship with our Adviser. For additional information regarding these conflicts, see "Conflicts of Interest."

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 "Distribution Policy" and "Investment Policies and Policies with Respect to Certain Activities — Use of Leverage."

**Qualitative Disclosures about Market Risk**

Market risk includes risks that arise from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market sensitive instruments. In pursuing our business plan, we expect that the primary market risk to which we will be exposed is interest rate risk.

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

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

## 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 selectively making long-term mortgage loans. Our Adviser, Gladstone Management Corporation, serves as our external adviser and manages our business. We expect that a large portion of our tenants and borrowers will consist of small and medium-sized businesses having significant buyout fund ownership and will be well capitalized, with equity constituting between 20% and 40% of their permanent capital. We expect that other tenants and borrowers will be family-owned businesses that have built significant equity from paying down the mortgage loans securing their real estate or through the appreciation in the value of their real estate. Although we have not yet purchased any properties or made any mortgage loans, we are actively communicating with buyout funds, real estate brokers and other third parties to locate 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 are owned 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 selectively offer long-term mortgage loans on competitive terms and conditions.

### OUR BUSINESS STRATEGY

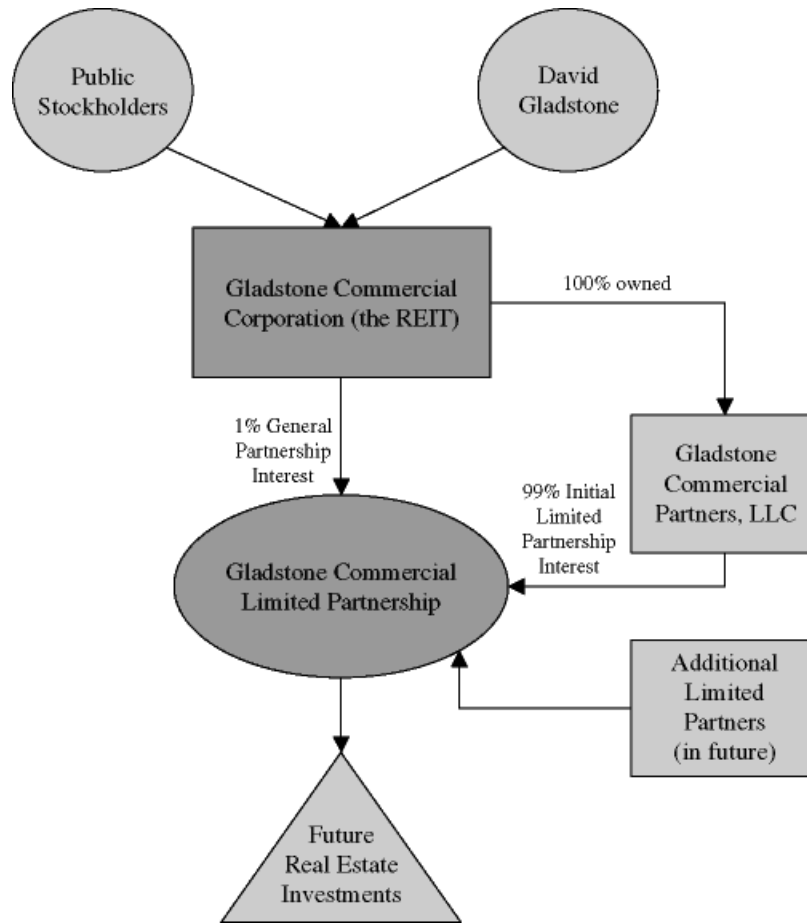
Our principal investment objectives are to generate income for our stockholders in the form of quarterly cash distributions that grow over time and to increase the value of our common stock. Our primary strategy to achieve our investment objectives is to utilize the substantial knowledge and experience 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 to occasionally 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 selectively 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 or borrowers;
- 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.

## OUR STRUCTURE

The following diagram depicts our ownership structure upon completion of this offering. Our Operating Partnership will own our real estate investments directly or indirectly, in some cases through special purpose entities that we may create in connection with the acquisition of real property.





## 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. At this time, we are unable to estimate how much of our portfolio will be invested in real property and how much will be invested in mortgage loans. We expect that the vast majority of our investments will be structured as net leases, but if a net lease would have an adverse impact on a potential tenant, or would otherwise be inappropriate for us, we may structure our investment as a mortgage loan. 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 economic 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 if our Adviser makes inadvisable investment or management decisions, our operations could be materially adversely impacted.”

We anticipate that we will make substantially all of our investments through our Operating Partnership. 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 mortgage payments, which could adversely affect our cash available to make distributions to our stockholders.”

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. Our board of directors has adopted a policy that we will not make an investment in any individual property with a cost in excess of 20% of our total assets at the time of investment. However, our board of directors may amend or waive this policy at any time or from time to time.

### *Investments in mortgage loans*

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

To the extent that we invest in mortgage loans, we will generally originate those loans. However, we may also purchase mortgage loans from other lenders if consistent with our investment objectives. Our Adviser will service the mortgage loans in our portfolio by collecting monthly principal and interest payments on our behalf. From time to time, we may sell mortgage loans that we hold to third parties; however, we do not intend to engage in warehousing of mortgage loans.

### **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 mortgage loans on our behalf (all criteria may not be present for each lease or mortgage 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 are owned by buyout funds and are well capitalized, with equity constituting between 20% and 40% of their permanent capital. 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 distribution 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 mortgage 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 mortgage loans and the anticipated and actual cash flow from the underlying real property. Our mortgage loans may include first mortgage loans, leasehold mortgage loans and conventional mortgage loans without equity enhancements.

Except as described below, any mortgage 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 mortgage loan generally will be secured by property with a demonstrable income-producing potential. In determining whether to make a mortgage 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 mortgage loan, we will generally require a mortgagee's title insurance policy or commitment as to the lien priority of a mortgage or the condition of title in connection with each mortgage loan. We 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 mortgage 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 mortgage loans that, when combined with existing loans that are on a parity with or senior to our mortgage loan, exceed 85% of the appraised value of any underlying real property, our Adviser 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 mortgage loans that are subordinated to a first mortgage on a property. For example, if the property is subject to an economic development loan as a first mortgage at a particularly low interest rate, we may make a second mortgage loan on the property. However, we will not make a second mortgage loan on any property that we would not consider owning, subject to existing senior financing, and leasing to the tenant.

From time to time, we may purchase mortgage loans, including loans being sold at a discount, from banks and other financial institutions if the subject property otherwise satisfies our underwriting criteria. 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, and we will not acquire equity interests in any entity other than in connection with a lease or mortgage loan transaction. 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 mortgage 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 use borrowings as a financing mechanism 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. We will seek to structure all borrowings as non-recourse loans. The use of non-recourse financing allows us to limit our exposure to the amount of equity invested in the properties pledged as collateral for our borrowings. Non-recourse financing generally restricts a lender’s claim on the assets of the borrower and, as a result, the lender generally may look only to the property securing the debt for satisfaction of the debt. We believe that this financing strategy, to the extent



available, will protect our other assets. However, we can provide no assurance that non-recourse financing will be available on terms acceptable to us, or at all, and there may be circumstances where lenders have recourse to our other assets. There is no limitation on the amount we may borrow against any single investment property. Neither our articles of incorporation nor our bylaws impose any limitation on our borrowing, but our board of directors has adopted a policy limiting our aggregate borrowings 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 make 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 distributions. 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 seven.

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	61	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	56	Chief Financial Officer and Treasurer
David A.R. Dullum	55	Director (1)(2)(3)(4)
Michela A. English	53	Director (1)(3)
Anthony W. Parker	57	Director (1)(2)(3)(4)
Paul W. Adelgren	60	Director (1)(5)
Maurice W. Coulon	60	Director (1)(5)

- (1) Messrs. Dullum, Parker, Adelgren and Coulon 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 and rejoined the board of directors of Gladstone Capital in July 2003. 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 managing director and partner of Columbia Capital, a venture capital firm focused on investments in communications and information technology. From 1989 to 1997, Mr. Stelljes held various positions, including executive vice president and principal, with Allied Capital and its affiliates. 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 1976 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. Mr. Parker is currently the sole shareholder of Parker & Associates, P.C., a law firm. 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.

*Maurice W. Coulon.* Mr. Coulon has agreed to become a director prior to the completion of this offering. Since 2000, Mr. Coulon has been a private investor in real estate. From 1991 through his retirement in 2000, Mr. Coulon served as director of portfolio management for the Morgan Stanley Real Estate Fund. From 1980 to 1991, Mr. Coulon served as senior vice president of asset management for the Boston Company Real Estate Counsel, Inc. Mr. Coulon was a founder of the National Association of Real Estate Investment Managers and is a past president of the National Council of Real Estate Investment Fiduciaries. Mr. Coulon holds a MBA from Harvard University.

#### **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 and senior vice president of Allied Capital Corporation. At Allied Capital, Mr. Cooper was responsible for marketing, sourcing, underwriting, managing, financing and servicing all forms of commercial real estate. During his time at Allied Capital, Mr. Cooper administered an investment portfolio of over \$250 million and was a member of the real estate credit committee. 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 analyst 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 BS 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 Messrs. Brubaker, Dullum and Coulon 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 five 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 these 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, retention and approval of the compensation of our 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 Mr. Coulon, 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 committee 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 ending December 31, 2003 other than for board service.

### *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: 200,000 shares
- Terry Lee Brubaker: 100,000 shares
- George Stelljes, III: 100,000 shares
- Harry Brill: 25,000 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, including those of our Adviser, 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 759,000 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, cash or stock 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 2.0% 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 mortgage 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 mortgage 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 2.0% 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 2.0% 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 2.0% 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.

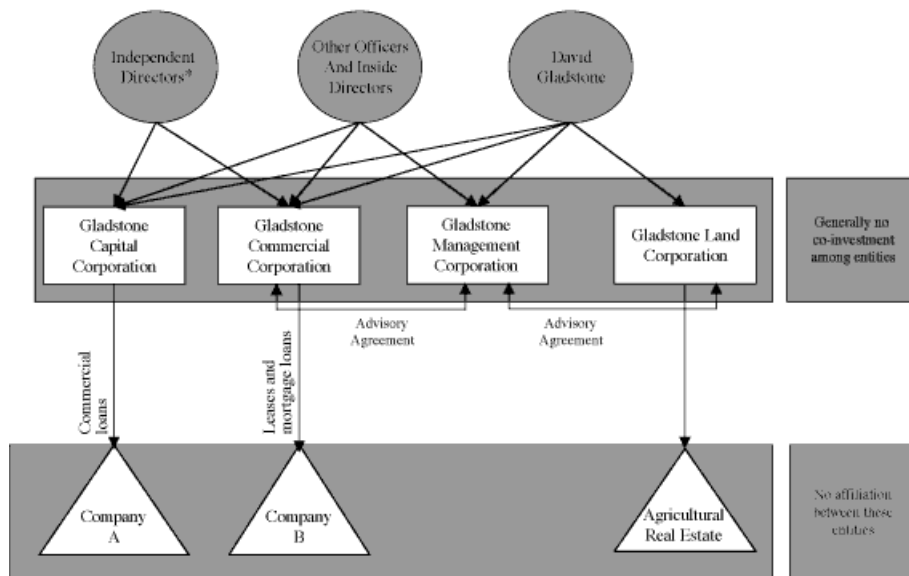
**Our Affiliates**

All of our officers and all but one of our directors 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 real estate lease or mortgage 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. We will obtain approval of our stockholders before we change our policy on co-investments with affiliates. 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 real estate lease or mortgage loan arrangement. The following chart illustrates generally the relationship among us, our Adviser and our affiliates.

**Gladstone Commercial Corporation and Its Affiliates**



\* Mr. Coulon is not affiliated with Gladstone Capital.

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, on occasion 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, Gladstone Capital may make such a loan as an accommodation to a borrower that otherwise meets its investment criteria, but any such loans will generally not have terms exceeding five years. Therefore, Gladstone Capital may compete with us with respect to making short-term 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 entity 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.

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 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.

Name of Beneficial Owner	Number of Shares Beneficially Owned	Percent of Class (1)
David Gladstone (2)	252,000	4.4%
Terry Lee Brubaker (3)	50,000	*
George Stelljes, III (4)	50,000	*
Harry Brill (5)	12,500	*
David A.R. Dullum (6)	0	*
Michela A. English (6)	0	*
Anthony W. Parker (6)	0	*
Paul W. Adलगren (6)	0	*
Maurice W. Coulon (6)	0	*
All executive officers and directors as a group (nine persons) (7)	364,500	6.2%

\* 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) Includes (i) 100,000 shares underlying options to be granted concurrently with this offering to Mr. Gladstone that will be immediately exercisable upon grant and (ii) 100,000 shares that Mr. Gladstone has expressed to us that he intends to purchase in this offering under the directed share program (although there can be no guarantee that he will purchase such shares).
- (3) Reflects 50,000 shares underlying options to be granted concurrently with this offering to Mr. Brubaker that will be immediately exercisable upon grant.
- (4) Reflects 50,000 shares underlying options to be granted concurrently with this offering to Mr. Stelljes that will be immediately exercisable upon grant.
- (5) Reflects 12,500 shares underlying options to be granted concurrently with this offering to Mr. Brill that will be immediately exercisable upon grant.
- (6) Messrs. Dullum, Parker, Adलगren and Coulon and Ms. English have agreed to join our board of directors prior to the completion of this offering.
- (7) Includes (i) 212,500 shares underlying options to be granted to our executive officers concurrently with this offering, as described more fully in footnotes (2) through (5) above, and (ii) 100,000 shares of common stock that Mr. Gladstone has expressed to us that he intends to purchase in this offering under the directed share program (although there can be no guarantee that he will purchase such shares).

## 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), 5,552,000 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 “Distribution 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, 5,552,000 shares of our common stock will be outstanding, based on the number of shares outstanding on July 22, 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 5,500,000 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, which was formed in May 2003 to acquire, own and operate properties on our behalf. We will control our Operating Partnership as its sole general partner, and through our wholly-owned subsidiary, Gladstone Commercial Partners, LLC, we 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 or preferred 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.

Our structure of conducting our business through our Operating Partnership is commonly called an Umbrella Partnership Real Estate Investment Trust, or UPREIT, structure, which is utilized generally to provide for the acquisition of real property from owners who desire to defer taxable gain that would otherwise be recognized by them upon the disposition of their property. These owners may also desire to achieve diversity in their investment and other benefits afforded to owners of stock in a REIT. For purposes of satisfying the asset and income tests for qualification as a REIT for tax purposes, the REIT's proportionate share of the assets and income of an UPREIT partnership, such as our Operating Partnership, will be deemed to be assets and income of the REIT.

A property owner may contribute property to an UPREIT partnership in exchange for limited partnership units on a tax-deferred basis. In addition, our Operating Partnership is structured to make

distributions with respect to limited partnership units that will be equivalent to the dividend distributions made to holders of our common stock. Finally, a limited partner in our Operating Partnership may later exchange his or her limited partnership units in our Operating Partnership for shares of our common stock in a taxable transaction as described below.

### **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 interests to our Operating Partnership in exchange for limited partnership units, rather than contributing their interests to us in exchange for cash or shares of our common stock in fully taxable transactions. 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, limited partners other than our subsidiaries may redeem each partnership unit then held by them 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 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 Internal Revenue Code.

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 as the general partner of our Operating Partnership, engage in any merger, consolidation or other business combination or transfer or assign our interest in our Operating Partnership (except to a wholly owned subsidiary) unless the transaction in which such withdrawal, business combination or transfer occurs results in the limited partners receiving or having the right to receive cash, securities or other 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, in the case of a merger or other business combination, our successor contributes substantially all of its assets to our Operating Partnership in return for a general partnership interest in our Operating Partnership. We may also enter into a business combination or transfer our general partnership interest upon the receipt of the consent of a majority in interest of the limited partners of the 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 a capital contribution in exchange for limited partnership interests. 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***

The limited partners of our Operating Partnership, other than any of our subsidiaries, such as Gladstone Commercial Partners, LLC, have the right to cause their limited partnership units to be redeemed by our Operating Partnership for cash or, at our election, shares of our common stock on a one-for-one basis. In the event that the partnership units are redeemed for cash, the cash amount to be paid

will be equal to the market value of the number of our shares of common stock that would be issuable if the limited partnership units were redeemed for our shares on a one-for-one basis. If we elect to redeem the limited partnership units for shares of our common stock, we will issue one share of our common stock for each limited partnership unit redeemed. These redemption rights may not be exercised, however, if and to the extent that the delivery of shares of common stock in such redemption would (1) result in any person owning shares in excess of our ownership limits, (2) result in shares being owned by fewer than 100 persons, (3) cause us to be “closely held” within the meaning of Section 856(h) of the Internal Revenue Code, (4) cause us to own 10.0% or more of the ownership interests in a tenant within the meaning of Section 856(d)(2)(B) of the Internal Revenue Code, or (5) cause the acquisition of shares of common stock by a redeemed limited partner to be “integrated” with any other distribution of our shares of common stock for purposes of complying with the Securities Act.

Subject to the foregoing, limited partners of our Operating Partnership may exercise their redemption rights at any time after one year following the completion of this offering. However, a limited partner may not deliver more than two redemption notices in any calendar year and may not exercise a redemption right for less than 1,000 limited partnership units, unless such limited partner holds less than 1,000 units, in which case he must exercise his redemption right for all of his units. We do not expect to issue any of the shares of common stock offered hereby to limited partners of our Operating Partnership in redemption of their limited partnership units. Rather, in the event a limited partner of our Operating Partnership exercises its redemption rights, and we elect to purchase the limited partnership units with shares of our common stock, we expect to issue new unregistered shares of common stock in connection with such transaction.

If we redeem any shares of our common stock or shares of any series of preferred stock that we may issue, then our Operating Partnership will redeem, for the same cash amount as paid in such redemption, the same number of units of partnership interest held by us or our subsidiaries corresponding to the shares we redeem.

### ***Distributions***

The partnership agreement provides that our Operating Partnership will distribute cash flow from operations to the limited partners of our Operating Partnership in accordance with their relative percentage interests on at least a quarterly basis in amounts determined by us, such that a holder of one unit of limited partnership interest in our Operating Partnership will receive the same amount of annual cash flow distributions from our Operating Partnership as the amount of annual distributions paid to the holder of one of our shares of common stock. Remaining cash from operations will be distributed to us as the general partner to enable us to make distributions to our stockholders.

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

The partnership agreement of our Operating Partnership provides that taxable income is allocated to the limited partners of our Operating Partnership in accordance with their relative percentage interests such that a holder of one unit of limited partnership interest in our Operating Partnership will be allocated taxable income for each taxable year in an amount equal to the amount of taxable income to be recognized by a holder of one of our shares, subject to compliance with the provisions of Section 704(b) and 704(c) of the Internal Revenue Code and corresponding Treasury Regulations. Losses, if any, will generally be allocated among the partners in accordance with their respective percentage interests in our Operating Partnership.

Upon the liquidation of our Operating Partnership, after payment of debts and obligations, any remaining assets of our Operating Partnership will be distributed to partners with positive capital accounts on a pro rata basis in accordance with their respective positive capital account balances. If we were to have a negative balance in our capital account following a liquidation, we, as general partner of the Operating Partnership, would be obligated to contribute cash to our Operating Partnership equal to such negative balance for distribution to other partners, if any, having positive balances in such capital accounts.

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 Jefferies & Company, Inc. J.J.B. Hilliard, W.L. Lyons, Inc. Stifel, Nicolaus & Company, Incorporated	<hr/> 5,500,000 <hr/>

The underwriters propose to offer shares of our common stock, other than directed shares discussed below, 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.

### Directed Share Program

At our request, the underwriters have reserved up to 1,100,000 shares, or approximately 20% 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 such shares after the registration statement of which this prospectus is a part has been declared effective by the SEC but no later than the close of business on 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 reserved for purchase 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 underwriting 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.

**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(1)	Total with Over-allotment(1)
Underwriting discount to be paid to the underwriters by us			

(1) Assumes the sale of all 1,100,000 reserved shares in the directed share program at the offering price less the underwriters discount, with respect to which no underwriting discount will 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 825,000 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 Agreements**

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. In addition, purchasers in the directed share program will be subject to separate lockup agreements restricting their resale of shares purchased pursuant to the directed share program for a period of 180 days following the completion of the offering. 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 other than with respect to our issuance of shares of common stock upon exercise by the underwriters of their over-allotment option.

### **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.

#### **Listing of Shares**

We have applied to list the shares of common stock proposed to be sold in this offering on the Nasdaq National Market, under the symbol "GOOD."

#### **EXPERTS**

The financial statements as of June 30, 2003 and for the period from February 14, 2003 (inception) through June 30, 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**

As a result of this offering, we will become subject to the information and reporting requirements of the Securities Exchange Act of 1934, as amended, as a result of which we will file annual, quarterly and other periodic reports and proxy statements. 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 filed with the SEC containing unaudited financial data for the first three quarters of each fiscal year within 45 days after the end of each fiscal quarter.

#### **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 AUDITORS

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 equity and cash flows present fairly, in all material respects, the financial position of Gladstone Commercial Corporation (the "Company") at June 30, 2003, and the results of its operations and its cash flows for the period from February 14, 2003 (inception) to June 30, 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

July 18, 2003

GLADSTONE COMMERCIAL CORPORATION

BALANCE SHEET

June 30, 2003

<b>ASSETS:</b>	
Cash and cash equivalents	\$ 29,615
Deferred offering costs	298,815
	<hr/>
Total assets	\$328,430
	<hr/>
<b>LIABILITIES AND STOCKHOLDER'S EQUITY</b>	
Liabilities	
Accounts payable	\$287,084
	<hr/>
Stockholder's Equity	
Common stock, \$0.001 par value, 20,000,000 shares authorized, 52,000 shares outstanding	52
Additional paid in capital	51,948
Retained deficit	(10,654)
	<hr/>
Total stockholder's equity	41,346
	<hr/>
Total liabilities and stockholder's equity	\$328,430
	<hr/>

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 June 30, 2003

REVENUES:	\$ —
EXPENSES:	
Organizational costs	5,549
General and administrative	5,105
Total expenses	10,654
Net loss	\$(10,654)
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 EQUITY

For the Period February 14, 2003 (Inception) to June 30, 2003

	Common Stock	Additional Paid in Capital	Stock Subscription Receivable	Retained Deficit	Total
Issuance of common shares	\$ 52	\$51,948	\$ (42,000)	\$ —	\$ 10,000
Payment of stock subscription receivable			42,000		42,000
Net loss				(10,654)	(10,654)
Balance, June 30, 2003	\$ 52	\$51,948	\$ —	\$(10,654)	\$ 41,346

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 June 30, 2003

Cash flows from operating activities:	
Net loss	\$(10,654)
Increase in accounts payable	10,654
	<u>          </u>
Net cash used by operating activities	—
	<u>          </u>
Cash flows from investing activities:	
Proceeds from share issuance	52,000
Payments for deferred offering costs	(22,385)
	<u>          </u>
Net cash provided by financing activities	29,615
	<u>          </u>
Net increase in cash and cash equivalents	29,615
Cash and cash equivalents, beginning of period	—
	<u>          </u>
Cash and cash equivalents, end of period	\$ 29,615
	<u>          </u>
Non cash investing and financing activities:	
Deferred offering costs of \$276,430 have been accrued and included in accounts payable.	

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.

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 are consolidated with those of the Company.

A minimum of 5,500,000 and a maximum of 6,325,000 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

##### Investments in real estate

The Company intends to use the net proceeds of the Offering to make investments in real estate. The Company will record investments in real estate at cost and will capitalize improvements and replacements when they extend the useful life or improve the efficiency of the asset. The Company will expense costs of repairs and maintenance as incurred. The Company 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.

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

The fair value of the tangible assets of an acquired property (which includes land, building and tenant improvements) will be determined by valuing the property as if it were vacant, and the "as-if-vacant" value is then allocated to land, building and tenant improvements based on management's determination of the relative fair values of these assets. Management will determine the as-if-vacant fair value of a property using methods similar to those used by independent appraisers. Factors to be considered by management in performing these analyses include an estimate of carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases. In estimating carrying costs, management will include real estate taxes, insurance and other operating expenses and estimates of lost rental revenue during the expected lease-up periods based on current market demand. Management will also estimate costs to execute similar leases including lease commission, legal and other related costs.

## GLADSTONE COMMERCIAL CORPORATION

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

In allocating the fair value of the identified intangible assets and liabilities of an acquired property, any above-market and below-market in-place lease values will be recorded based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. The capitalized above-market lease values will be amortized as a reduction of rental income over the remaining non-cancelable terms of the respective leases. The capitalized below-market lease values will be amortized as an increase to rental income over the initial term and any fixed rate renewal periods in the respective leases.

The aggregate value of any other acquired intangible assets, such as in-place leases and tenant relationships, will be measured by the excess of (i) the purchase price paid for a property after adjusting existing in-place leases to market rental rates over (ii) the estimated fair value of the property as if vacant, determined as set forth above. This aggregate value will be allocated between in-place lease values and tenant relationships based on management's evaluation of the specific characteristics of each acquisition. The value of in-place leases (exclusive of the value of above-market and below-market in-place leases, tenant relationships, and other intangible assets will be amortized to expense over the period that the intangibles benefit.

The Company has 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 the Company intends to sell be presented as discontinued operations in the statement of operations for all periods presented, and properties the Company intends to sell be designated as "held for sale" on its balance sheet.

When circumstances such as adverse market conditions indicate a possible impairment of the value of a property, the Company will review the recoverability of the property's carrying value. The review of recoverability will be based on the Company's estimate of the future undiscounted cash flows, excluding interest charges, expected to result from the property's use and eventual disposition. The Company's 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.

#### **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 June 30, 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.

#### **Deferred offering costs**

Costs incurred related to the Offering have been deferred and will be charged to stockholder's equity upon completion of the Offering. In the event that the Offering is not completed, these costs will be charged to expense.



GLADSTONE COMMERCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

**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.

The Company will reimburse the Adviser for all expenses incurred by the Adviser for its direct benefit. Examples of these expenses include expenses incurred in connection with the Company's 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 the Adviser and its affiliates in connection with the Offering, which amount is not determinable at this time. The Company currently estimates these expenses will be approximately \$1.3 million (including approximately \$1 million of expenses incurred in connection with the Offering) during the first twelve months. The Company estimates that these expenses will be approximately \$300,000 per year after the first twelve months following the Offering.

In addition, the Company will reimburse the Adviser for all fees charged by third parties that are directly related to the Company's business, which may include real estate brokerage fees, mortgage placement fees, lease-up fees and transaction structuring fees that will be passed through to the Company at the cost to the Adviser. The actual amount that the Company will pay to the Adviser will depend largely upon the aggregate costs of the properties the Company acquires and mortgage loans that it makes, which in turn will depend upon the proceeds of the Offering and the amount of leverage the Company uses in connection with its activities. Accordingly, the amount of these fees is not determinable at this time.

The Company will also reimburse the Adviser for the Company's pro rata portion of the 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 the Adviser, multiplied by the ratio of hours worked by the Adviser's employees on the Company's projects to the total hours worked by the Adviser's employees, subject to a maximum of 2.0% of the Company's average invested assets for the year. The Adviser will bill the Company on a monthly basis for these amounts. The Adviser must refund to the Company at least annually the amount by which amounts billed to and paid by the Company exceed this 2.0% limit during a given year. To the extent that operating expenses payable or reimbursable by the

**GLADSTONE COMMERCIAL CORPORATION**

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

Company exceed this limit and the Company's independent directors determine that the excess expenses 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 expenses, or any portion thereof, but only to the extent that the reimbursement would not cause the Company's operating expenses to exceed the 2.0% limitation in any year.

**4. Equity Incentive Plan**

Effective June 10, 2003, the Company adopted the 2003 Equity Incentive Plan, (the "2003 Plan"), for the purpose of attracting and retaining the services of executive officers, directors and other key employees. Under the 2003 Plan, the Company's 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 the Adviser and its affiliates. In addition, the 2003 Plan permits the granting of restricted stock. The Company has authorized the issuance of 759,000 shares of common stock to its officers, directors, employees and consultants, including the employees and directors of the Adviser under the 2003 Plan. Grants to employees and directors of the Adviser may potentially have different accounting consequences than grants to potential employees. The Company will evaluate this at the time of any future grants.

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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.



**GLADSTONE**

**COMMERCIAL  
CORPORATION**

**5,500,000**

**Shares of Common Stock**

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PROSPECTUS

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**Ferris, Baker Watts**

Incorporated

**Jefferies & Company, Inc.**

**J.J.B. Hilliard, W.L. Lyons, Inc.**

**Stifel, Nicolaus & Company,**

Incorporated

, 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	\$ 7,675
Nasdaq listing fee	100,000
Printing and engraving fees	150,000*
Legal fees and expenses	500,000*
Accounting fees and expenses	50,000*
Transfer Agent and Registrar fees	25,000*
Road Show Expenses	75,000*
Miscellaneous	92,325*
Total	<u>\$1,000,000</u>

\* Estimated.

**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. This directors and officers insurance will generally cover claims made against our directors and officers based on their actions and omissions in connection with the carrying out of our business affairs.

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

Not applicable.

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

(a) *Financial Statements.*

Report of Independent Auditors	F-2
Balance Sheet as of June 30, 2003	F-3
Statement of Operations for the Period February 14, 2003 (inception) to June 30, 2003	F-4
Statement of Stockholder's Equity for the Period February 14, 2003 (inception) to June 30, 2003	F-5
Statement of Cash Flows for the Period February 14, 2003 (inception) to June 30, 2003	F-6
Notes to Financial Statements	F-7

(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
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	Amended and Restated Advisory Agreement between the Registrant and Gladstone Management Corporation, dated July 21, 2003
10.2	2003 Equity Incentive Plan, as amended
10.3	Agreement of Limited Partnership of Gladstone Commercial Limited Partnership, dated July 17, 2003.
21.1	Subsidiaries
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
23.8	Consent of Maurice W. Coulon
24.1†	Power of attorney (included in the signature page to this registration statement)

† Previously filed.

\* 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 Pre-Effective Amendment No. 1 to Registration Statement on Form S-11 (this "Amendment") to be signed on its behalf by the undersigned, thereunto duly authorized, in the County of Fairfax, Commonwealth of Virginia, on the 21st day of July, 2003.

GLADSTONE COMMERCIAL CORPORATION

By: /s/ DAVID J. GLADSTONE

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

Pursuant to the requirements of the Securities Act of 1933, as amended, this Amendment 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)	_____ July 21, 2003
_____ * _____ Terry Lee Brubaker	_____ President, Secretary, Chief Operating Officer and Director	_____ July 21, 2003
_____ * _____ Harry Brill	_____ Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)	_____ July 21, 2003

\*By: /s/ DAVID J. GLADSTONE

\_\_\_\_\_  
 David J. Gladstone  
*Attorney-in-fact*

## Exhibit Index

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\* To be filed by amendment.

GLADSTONE COMMERCIAL CORPORATION

5,500,000 SHARES OF COMMON STOCK

(\$0.001 PAR VALUE PER SHARE)

UNDERWRITING AGREEMENT

August \_\_, 2003

Ferris, Baker Watts, Incorporated  
Jefferies & Company, Inc.  
J.J.B Hillard, W.L. Lyons, Inc.  
Stifel, Nicolaus & Company, Incorporated  
c/o Ferris, Baker Watts, Incorporated  
7601 Lewinsville Road  
Suite 450  
McLean, Virginia 22102

Ladies and Gentlemen:

Gladstone Commercial Corporation, a Maryland corporation (the "Company") proposes to sell to the several underwriters named in Schedule I (collectively, the "Underwriters") an aggregate of 5,500,000 shares (the "Firm Shares") of the Company's common stock, \$0.001 par value per share (the "Common Stock"). All of the Firm Shares will be sold by the Company. The Firm Shares are to be sold to each Underwriter, acting severally and not jointly, in such amounts as are set forth in Schedule I opposite the name of such Underwriter.

Solely for the purpose of covering over-allotments in the sale of the Firm Shares, the Company grants to the Underwriters the right to purchase up to an additional 825,000 shares of Common Stock (the "Option Shares"), which option shall be exercisable in the manner, and such Option Shares shall be sold in the denominations, set forth in Section 3(b) below. The Firm Shares and Option Shares are herein sometimes referred to as the "Shares."

The Company is the general partner of Gladstone Commercial Limited Partnership (the "Operating Partnership"), a Delaware limited partnership that serves as the Company's primary operating partnership subsidiary.

Section 1. Representations and Warranties of the Company and Operating Partnership. The Company and the Operating Partnership jointly and severally represent and warrant to, and agree with, each of the Underwriters that:

(a) The Company has prepared and filed with the Securities and Exchange Commission (the "Commission") a registration statement on Form S-11 (Registration No. 333-106024) with respect to the Shares, including a preliminary form of prospectus subject to completion, in conformity with the requirements of the Securities Act of 1933, as amended (the

"1933 Act"), and the rules and regulations of the Commission thereunder (all such rules and regulations, including Regulation S-X to the extent applicable, referred to as the "1933 Act Regulations"); and such amendments to such registration statement as may have been required, if any, prior to the date hereof have been filed with the Commission, and such amendments have been similarly prepared. Copies of such registration statement and amendment or amendments and of each related preliminary prospectus, and the exhibits, financial statements and schedules, as finally amended and revised, have been delivered to you. The Company has prepared in the same manner, and proposes so to file with the Commission, one of the following: (i) prior to effectiveness of such registration statement, a further amendment thereto, including the form of final prospectus, (ii) if the Company does not rely on Rule 434 of the 1933 Act Regulations, a final prospectus in accordance with Rules 430A and 424(b) of the 1933 Act Regulations, or (iii) if the Company relies on Rule 434 of the 1933 Act Regulations, a term sheet relating to the Shares that shall identify the preliminary prospectus that it supplements containing such information as is required or permitted by Rules 434, 430A and 424(b) of the 1933 Act Regulations. The Company also may file a related registration statement with the Commission pursuant to Rule 462(b) of the 1933 Act Regulations for the purpose of registering additional shares of Common Stock, which registration statement will be effective upon filing with the Commission. As filed, such amendment, any registration statement filed pursuant to Rule 462(b) of the 1933 Act Regulations and any term sheet and form of final prospectus, or such final prospectus, shall include all Rule 430A Information (as hereinafter defined) and, except to the extent that you shall agree in writing to a modification, shall be in all respects in the form furnished to you prior to the date and time that this Agreement was executed and delivered by the parties hereto, or, to the extent

not completed at such date and time, shall contain only such specific additional information and other changes (beyond that contained in the latest preliminary prospectus) as the Company shall have previously advised you in writing would be included or made therein.

The term "Registration Statement" as used in this Agreement shall mean such registration statement at the time such registration statement becomes effective and, in the event any post-effective amendment thereto becomes effective prior to the Closing Time (as hereinafter defined), shall also mean such registration statement as so amended; provided, however, that such term shall also include all Rule 430A Information contained in any Prospectus (as hereinafter defined) and any Term Sheet (as hereinafter defined) and deemed to be included in such registration statement at the time such registration statement becomes effective as provided by Rule 430A of the 1933 Act Regulations. The term "Preliminary Prospectus" shall mean any preliminary prospectus referred to in the preceding paragraph and any preliminary prospectus included in the Registration Statement at the time it becomes effective that omits Rule 430A Information. The term "Prospectus" as used in this Agreement shall mean (a) if the Company relies on Rule 434 of the 1933 Act Regulations, the Term Sheet relating to the Shares that is first filed pursuant to Rule 424(b)(7) of the 1933 Act Regulations, together with the Preliminary Prospectus identified therein that such Term Sheet supplements, or (b) if the Company does not rely on Rule 434 of the 1933 Act Regulations, the prospectus relating to the Shares in the form in which it is first filed with the Commission pursuant to Rule 424(b) of the 1933 Act Regulations or, if no filing pursuant to Rule 424(b) of the 1933 Act Regulations is required, shall mean the form of final prospectus included in the Registration Statement at the time such Registration Statement becomes effective. The term "Rule 430A Information" means information with

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respect to the Shares and the offering thereof permitted pursuant to Rule 430A of the 1933 Act Regulations to be omitted from the Registration Statement when it becomes effective. The term "462(b) Registration Statement" means any registration statement filed with the Commission pursuant to Rule 462(b) of the 1933 Act Regulations (including the Registration Statement and any Preliminary Prospectus or Prospectus incorporated therein at the time such registration statement becomes effective). The term "Term Sheet" means any term sheet that satisfies the requirements of Rule 434 of the 1933 Act Regulations. Any reference to the "date" of a Prospectus that includes a Term Sheet shall mean the date of such Term Sheet.

(b) No order preventing or suspending the use of any Preliminary Prospectus has been issued by the Commission and no proceedings for that purpose have been instituted or, to the knowledge of the Company, threatened by the Commission or the state securities authority of any jurisdiction, and each Preliminary Prospectus, at the time of filing thereof, conformed in all respects to the requirements of the 1933 Act and the 1933 Act Regulations and did not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading; provided, however, that this representation and warranty shall not apply to any statements or omissions made in reliance upon and in conformity with information furnished in writing to the Company by an Underwriter expressly for use in the Registration Statement or any 462(b) Registration Statement.

(c) When the Registration Statement and any 462(b) Registration Statement shall become effective, or any Term Sheet that is part of the Prospectus is filed with the Commission pursuant to Rule 434, when the Prospectus is first filed pursuant to Rule 424(b) of the 1933 Act Regulations, when any amendment to the Registration Statement or any 462(b) Registration Statement becomes effective, when any supplement to the Prospectus or Term Sheet is filed with the Commission, and at each Date of Delivery (as hereinafter defined in Section 3), (i) the Registration Statement, the 462(b) Registration Statement, the Prospectus, the Term Sheet and all amendments thereof and supplements thereto will conform in all respects with the requirements of the 1933 Act and the 1933 Act Regulations and (ii) neither the Registration Statement, the 462(b) Registration Statement, the Prospectus, any Term Sheet nor any amendment or supplement thereto, will contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances in which they were made, not misleading; provided, however, that this representation and warranty shall not apply to any statement or omission made in reliance upon and in conformity with information furnished to the Company in writing by an Underwriter expressly for use in the Registration Statement or any 462(b) Registration Statement.

(d) The Company has been duly formed and is existing as a corporation under and by virtue of the laws of the State of Maryland and is in good standing with the State Department of Assessments and Taxation of Maryland (the "SDAT"), with all requisite corporate power and authority to own, lease and license its properties, and conduct its business as currently carried on and described in the Prospectus. The Company has qualified to do business and is in good standing as a foreign corporation, in every jurisdiction in which the ownership or leasing of its properties or the nature or conduct of its business, as described in the Prospectus, requires such

qualification, except where the failure to do so would not have a material adverse effect on the condition, financial or otherwise, results of operations, cash flows or prospects of the Company and its Subsidiaries considered as one enterprise (a "Material Adverse Effect"). The Company does not own any interest in or control, directly or indirectly, any corporation, association or other entity except as set forth in the next paragraph.

(e) Upon completion of the offering of the Shares the Company will be the sole general partner of the Operating Partnership and will own a 100% interest in the Operating Partnership. The subsidiaries of the Company and the Operating Partnership are listed on Schedule II attached hereto (the "Subsidiaries"). Each Subsidiary has been duly organized and is validly existing as a limited partnership, limited liability company or corporation in good standing under the laws of its state of organization, with all requisite power and authority to own and lease its properties, and conduct its business as described in the Prospectus. Each Subsidiary has qualified to do business and is in good standing as a foreign limited partnership, limited liability company or corporation in every jurisdiction in which the ownership or leasing of its properties or the nature or conduct of its business, as described in the Prospectus, requires such qualification, except where the failure to do so would not have a Material Adverse Effect.

(f) The Company has the corporate power to enter into this Agreement and to consummate the transactions contemplated herein. The Company has the corporate power to issue, sell and deliver the Shares as provided herein. This Agreement has been duly authorized, executed and delivered by the Company and constitutes the valid and binding agreement of the Company enforceable against the Company in accordance with its terms, except to the extent that the indemnification and contribution provisions set forth in Section 9 of this Agreement may be limited by applicable law or equitable principles, and except as enforceability may be limited by bankruptcy, reorganization, moratorium or similar laws affecting the enforceability of creditors' rights generally and rules of law governing specific performance, injunctive relief and other equitable remedies. The capital stock, limited liability company interests or partnership interests, as the case may be, of each Subsidiary have been duly authorized and validly issued, are fully paid and non-assessable and, upon completion of the formation transactions described in the Prospectus will be, in the case of such interests to be owned directly or indirectly by the Company, free and clear of any security interest, mortgage, pledge, lien, encumbrance, claim or equity. No such equity interest in any Subsidiary was issued in violation of the preemptive or similar right of any security holder of such Subsidiary.

(g) The Operating Partnership has the full legal right, power and authority to enter into this Agreement and to consummate the transactions contemplated herein. This Agreement has been duly authorized, executed and delivered by the Operating Partnership and constitutes the valid and binding agreement of the Operating Partnership enforceable against the Operating Partnership in accordance with its terms, except to the extent that the indemnification and contribution provisions set forth in Section 9 of this Agreement may be limited by applicable law or equitable principles, and except as enforceability may be limited by bankruptcy, reorganization, moratorium or similar laws affecting enforceability of creditors' rights generally and rules of law governing specific performance, injunctive relief and other equitable remedies.

(h) Each consent, approval, authorization, order, designation or filing by or with any governmental agency or body necessary for the valid authorization, issuance, sale and delivery of the Shares, the execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereby, has been made or obtained by the Company or the Operating Partnership, and is in full force and effect, except as may be required under the 1933 Act, the 1933 Act Regulations or applicable state or foreign securities laws. The issuance, sale and delivery of the Shares, the execution, delivery and performance of this Agreement, and the consummation of the transactions contemplated by this Agreement, (i) will not result in a breach or violation of any of the terms and provisions of, or constitute a default by the Company under its Amended and Restated Articles of Incorporation, as further amended or restated (the "Articles of Incorporation") or Bylaws or by the Operating Partnership under its Certificate of Limited Partnership or Agreement of Limited Partnership, as amended and/or restated (the "Partnership Agreement") and (ii) will not result in a breach or violation of any of the terms or provisions of, or constitute a default by the Company or any Subsidiary, under, any provision of any indenture, mortgage, deed of trust, loan agreement, note, lease or other agreement or instrument to which the Company or any Subsidiary is a party or to which they or their properties is subject, or (iii) will not result in a breach or violation of any statute, judgment, decree, order, rule or regulation of any court or governmental agency or body applicable to the Company or any Subsidiary or any of their properties, except, in each case, for such breach or violation as would not have a Material Adverse Effect.

(i) The authorized, issued and outstanding shares of common stock of

the Company are as set forth in the Prospectus under the caption "Capitalization". All the issued and outstanding shares of Common Stock of the Company, including the Shares to be sold by the Company, have been duly authorized and validly issued, and are, or when issued against payment therefor as authorized by the Company's board of directors will be, fully paid and non-assessable. The shares of Common Stock of the Company conform in all material respects to the description of the Common Stock contained in the Registration Statement and the Prospectus. All offers and sales of the Company's shares of common stock prior to the date hereof were at all relevant times duly registered under the 1933 Act or were exempt from the registration requirements of the 1933 Act by reason of Sections 3(b), 4(2) or 4(6) thereof and were duly registered or the subject of an available exemption from the registration requirements of the applicable state securities or blue sky laws. The Shares to be sold by the Company, when issued and delivered by the Company and paid for pursuant to this Agreement, will be validly issued, fully paid and non-assessable and will conform in all material respects to the description thereof contained in the Prospectus. No preemptive rights of stockholders exist with respect to any of the Shares under the General Corporation Laws of the State of Maryland, the Articles of Incorporation or the Bylaws. No person or entity holds a right to require or participate in the registration under the 1933 Act of the Shares. No person or entity has a right of participation or first refusal with respect to the sale of the Shares by the Company. None of the issued shares of Common Stock of the Company has been issued in violation of any preemptive or similar rights. Except as described in the Registration Statement and Prospectus, (A) there are no outstanding options, warrants or other rights calling for the issuance of any shares of Common Stock of the Company or any security convertible into or exchangeable for capital stock of the Company, (B) there is no commitment, plan or arrangement to issue any shares of Common Stock of the Company or any security convertible into or exchangeable for shares of Common Stock of the

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Company, and (C) the Company does not own, directly or indirectly, any capital stock or other equity securities of any other corporation or any ownership interest in any partnership, limited liability company, joint venture, association or other entity. The Operating Partnership has not issued any security or other equity interest other than units of partnership interest issued to the Company and its wholly-owned subsidiaries ("Units"). None of the Units in the Operating Partnership has been or will be issued or is owned or held in violation of any preemptive right. The outstanding Units in the Operating Partnership have been issued by the Operating Partnership in compliance with applicable federal and state securities laws.

(j) The financial statements of the Company included in the Registration Statement and the Prospectus presents fairly the financial position of the Company as of the date specified in conformity with generally accepted accounting principles applied on a consistent basis and in conformity with Regulation S-X of the Commission. The amounts in the Prospectus under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" are accurately computed, fairly present the information shown therein and have been determined on a basis consistent with the financial statements included in the Registration Statement and the Prospectus. No other financial statements or schedules are required by Form S-11 or under the 1933 Act Regulations to be included in the Registration Statement, the Prospectus or any Preliminary Prospectus.

(k) PricewaterhouseCoopers LLP, which has audited and is reporting upon the financial statements included in the Registration Statement and the Prospectus, are, and were during the periods covered by their report included in the Registration Statement and the Prospectus, independent public accountants with respect to the Company and its Subsidiaries within the meaning of the 1933 Act and the 1933 Act Regulations.

(l) The Company has obtained, for the benefit of the Underwriters, from each of the Company's directors and executive officers named in the Registration Statement, a written agreement conforming to the description under "Lockup Agreement" in the "Underwriting" section of the Prospectus.

(m) Since the respective dates as of which information is given in the Registration Statement and the Prospectus, there has not been (i) any change in the capital stock, long-term debt, or short-term borrowings of the Company and the Subsidiaries on a consolidated basis; (ii) any event or development which could reasonably be seen as having a Material Adverse Effect; (iii) any liability or obligation, direct or contingent, incurred or undertaken by the Company or any Subsidiary, except for liabilities or obligations incurred in the ordinary course of business or which otherwise would not have a Material Adverse Effect; or (iv)

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any declaration or payment of any dividend or distribution of any kind on or with respect to the Company's shares of common stock.

(n) The Company is not in violation of its Articles of Incorporation or Bylaws and no Subsidiary is in violation of its applicable organizational documents (including, without limitation, partnership and limited liability company agreements) and, as of the date hereof, no default exists, and no event has occurred, nor state of facts exists, which, with notice or after the lapse of time to cure or both, would constitute a default in the due performance and observance of any obligation, agreement, covenant, consideration or condition contained in any indenture, mortgage, deed of trust, loan agreement, note, lease or other agreement or instrument to which the Company or any Subsidiary is a party or by which it or any of its properties is subject, and no violation of any law, order, rule, regulation, writ, injunction or decree of any government, governmental instrumentality or court, domestic or foreign, has occurred or exists, in any such case where the consequences of such violation or default would have a Material Adverse Effect.

(o) [Intentionally Omitted]

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(p) [Intentionally Omitted]

(q) The Company does not own any real or personal property or hold any property under a ground lease or other lease other than the lease of the company's principal executive offices.

(r) Except as described in the Prospectus, there is not pending, nor to the Company's and the Operating Partnership's knowledge threatened, any action, suit, proceeding, inquiry or investigation, against the Company, any Subsidiary or any of their respective officers, directors or stockholders or to which the properties, assets or rights of the Company or its Subsidiaries are subject, before or brought by any court or governmental agency or body or board of arbitrators, which would, if adversely determined, have a Material Adverse Effect, or which could prevent consummation of the transactions contemplated by this Agreement.

(s) There are no contracts or other documents required by the 1933 Act or the 1933 Act Regulations to be described in or incorporated by reference into the Registration Statement or the Prospectus or to be filed as exhibits to the Registration Statement which have not been

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accurately described in all material respects in the Prospectus or incorporated or filed as required. The agreements to which the Company or any Subsidiary is party which are described in the Registration Statement and the Prospectus are valid and enforceable in all material respects by the Company and/or its Subsidiary except as enforceability may be limited by bankruptcy, reorganization, moratorium or similar laws affecting the enforceability of creditors' rights generally and rules of law governing specific performance, injunctive relief and other equitable remedies, and, to the best of the Company's and the Operating Partnership's knowledge, no party thereto is in breach or default under any of such agreements except where such breach or default would not have a Material Adverse Effect.

(t) The Company or a Subsidiary owns, possesses or has obtained all permits, licenses, franchises, certificates, consents, orders, approvals and other authorizations of governmental or regulatory authorities and other third parties as are necessary to own or lease, its properties and to carry on its businesses as described in the Registration Statement, except where a failure to own, possess or obtain such permits, licenses, franchises, certificates, consents, orders, approvals and other authorizations would not have a Material Adverse Effect. Neither the Company nor the Operating Partnership has received any notice relating to termination, revocation or modification of any such license, permit, franchise, certificate, consent, order, approval or authorization, which termination, revocation or modification would have a Material Adverse Effect.

(u) The Company or a Subsidiary owns or possesses all trademarks, service marks, tradenames, trademark registrations, service mark registrations, copyrights, licenses, trade secrets, processes and other intangible property rights and know-how necessary for the conduct of its business as described in the Registration Statement (collectively, the "Intellectual Property"). Except as described in the Prospectus, (i) no third parties have received rights to any such Intellectual Property from the Company or any Subsidiary, other than licenses granted in the ordinary course of business; (ii) to the Company's and

the Operating Partnership's knowledge, there is no infringement by third parties of any such Intellectual Property, (iii) there is no pending or, to the Company's and the Operating Partnership's knowledge, threatened action, suit, proceeding or claim by others challenging the Company's or a Subsidiary's rights in or to any such Intellectual Property, and the Company and the Operating Partnership are unaware of any facts which would form a basis for any such claim; (iv) there is no pending or, to the Company's and the Operating Partnership's knowledge, threatened action, suit, proceeding or claim by others challenging the validity or scope of any such Intellectual Property, and the Company and the Operating Partnership are unaware of any facts which would form a basis for any such claim; and (v) there is no pending or, to the Company's and the Operating Partnership's knowledge, threatened action, suit, proceeding or claim by others that the Company or any Subsidiary infringes or otherwise violates, or would infringe or otherwise violate any patent, trademark, copyright, trade secret or other proprietary rights of others, and the Company and the Operating Partnership are unaware of any facts which would form a basis for any such claim.

(v) The Company, the Operating Partnership and each Subsidiary have implemented controls and other procedures that are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms and is accumulated and communicated to the Company's management, including its chief executive officer and chief financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure; and the Company makes and keeps books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company, the Operating Partnership and each Subsidiary; and the Company, the Operating Partnership and each Subsidiary maintain a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with existing assets at reasonable intervals and appropriate action is taken with respect to any differences; and, to the Company's knowledge, neither the Company, the Operating Partnership nor any Subsidiary, nor any employee or agent thereof, has made any payment of funds of the Company or any Subsidiary, as the case may be, or received or retained any funds, and no funds of the Company, the Operating Partnership or any Subsidiary, as the case may be, have been set aside to be used for any payment, in each case in violation of any law, rule or regulation.

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(w) The Company and each Subsidiary have filed all federal, state, local and foreign income and franchise tax returns and tax forms required to be filed and are not in default in the payment of any taxes which were payable pursuant to said returns or any assessments with respect thereto, other than any which the Company or such Subsidiary is contesting in good faith and as to which adequate reserves have been provided. Such returns and forms are complete and correct in all material respects. The Company and each Subsidiary have made all payroll withholdings required to be made by them with respect to employees. The charges, accruals and reserves on the books of the Company and each Subsidiary in respect of any tax liability for any year not finally determined are adequate to meet any assessments or reassessments for additional taxes. There have been no tax deficiencies asserted and, to the Company's and the Operating Partnership's knowledge, no tax deficiency might be reasonably asserted or threatened against the Company or any Subsidiary that could individually or in the aggregate have a Material Adverse Effect.

(x) The Company and its Subsidiaries maintain insurance (issued by insurers of recognized financial responsibility) of the types and in the amounts generally deemed adequate for their business and, to the Company's and the Operating Partnership's knowledge, generally consistent with insurance coverage maintained by similar companies in similar businesses, including, but not limited to, insurance covering real and personal property owned or leased by the Company and its Subsidiaries against theft, damage, destruction, acts of vandalism and all other risks customarily insured against, and casualty and liability insurance covering the Company's and its Subsidiaries' operations, all of which insurance is in full force and effect.

(y) No labor problem exists with the Company's or any Subsidiary's employees or, to the Company's and the Operating Partnership's knowledge, is threatened or imminent, that would have a Material Adverse Effect.

(z) Neither the Company nor its officers, directors, stockholders or affiliates, have taken, and such parties will not take, directly or indirectly, any action designed to, or that might be reasonably expected to, cause or result



in or constitute, the stabilization or manipulation of the price of the Shares to facilitate the sale or resale of the Shares.

(aa) The shares of Common Stock have been registered pursuant to Section 12(g) of the Securities Exchange Act of 1934, as amended (the "1934 Act") and the Shares have been approved for listing on the Nasdaq Stock Market's National Market (the "Nasdaq National Market") subject to official notice of issuance.

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(bb) Neither the Company nor any Subsidiary has incurred any liability for a fee, commission or other compensation on account of the employment of a broker or finder in connection with the transactions contemplated by this Agreement other than as contemplated hereby.

(cc) Neither the Company nor any Subsidiary is, nor will it become as a result of the transactions contemplated hereby, nor does it intend to conduct its business in a manner that could cause either of them to become, an "investment company" or a company controlled by an "investment company" within the meaning of the Investment Company Act of 1940, as amended.

(dd) Except as described in the Prospectus and except for the issuance of options to purchase shares of Common Stock pursuant to the Company's 2003 Equity Incentive Plan, the Company has not sold or issued any shares of Common Stock during the six-month period preceding the date of the Prospectus, including any sales pursuant to Rule 144A under, or Regulations D or S of, the 1933 Act Regulations.

(ee) [Intentionally Omitted]

(ff) No relationship, direct or indirect, exists between or among the Company on the one hand, and the directors, officers, or stockholders of the Company on the other hand, which is required to be described in the Prospectus and which is not so described.

(gg) [Intentionally Omitted]

(hh) The Company is organized in conformity with the requirements for qualification as a real estate investment trust under the Internal Revenue Code of 1986, as amended (the "Code"), and the Company's method of operation will enable it to meet the requirements for taxation as a real estate investment trust under the Code. The Operating Partnership will be treated as partnerships for federal income purposes and not as a corporation or association taxable as a corporation.

(ii) The Company and its Subsidiaries are in compliance in all material respects with all currently applicable provisions of the Employee Retirement Income Security Act of 1974, as amended, including the regulations and published interpretations thereunder (herein called "ERISA"); no "reportable event" (as defined in ERISA) has occurred with respect to any "pension plan" (as defined in Section 3(2) ERISA) for which the Company or any Subsidiary would have any liability; the Company and its Subsidiaries have not incurred and do not expect to incur liability under (i) Title IV of ERISA with respect to termination of, or withdrawal from, any "pension plan" or (ii) Sections 412 or 4971 of the Code; and each "pension plan" for which

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the Company or any Subsidiary would have any liability that is intended to be qualified under Section 401(a) of the Code is so qualified in all material respects and nothing has occurred, whether by action or by failure to act, that would reasonably be expected to cause the loss of such qualification.

Section 2. [Intentionally Omitted]

Section 3. Sale and Delivery of Shares to the Underwriters; Closing.

(a) On the basis of the representations and warranties herein contained, and subject to the terms and conditions herein set forth, the Company agrees to sell to the Underwriters named in Schedule I hereto, and each such Underwriter agrees, severally and not jointly, to purchase from the Company, at a purchase price of \$\_\_\_\_\_ per share, the aggregate number of Firm Shares set forth opposite the name of such Underwriter in Schedule I hereto. The purchase price represents an initial public offering price of \$\_\_\_\_\_ per share and an underwriting discount of \$\_\_\_\_\_ per share.

(b) On the basis of the representations and warranties herein

contained, and subject to the terms and conditions herein set forth, the Company hereby grants an option to the Underwriters, to purchase up to an additional 825,000 Option Shares on the same terms and conditions as the Firm Shares. The option hereby granted will expire if not exercised within the 30 day period after the first date on which the Firm Shares are released by you for sale to the public. The option granted hereby may be exercised by you, as Representatives of the several Underwriters, in whole or in part (but not more than once), only for the purpose of covering over-allotments that may be made in connection with the offering and distribution of the Firm Shares, by giving written notice to the Company. The notice of exercise shall set forth the number of Option Shares as to which the several Underwriters are exercising the option, and the time and date of payment and delivery thereof. Such time and date of delivery (the "Date of Delivery") shall be determined by you but shall not be earlier than the second business day after the date on which the notice of the exercise of the option shall have been given nor later than seven full business days after the exercise of such option, nor in any event prior to the Closing Time. If the option is exercised as to all or any portion of the Option Shares, the Option Shares as to which the option is exercised shall be purchased by the Underwriters, severally and not jointly, in their respective underwriting obligation proportions.

(c) Payment of the purchase price for and delivery of the Firm Shares shall be made at the offices of Ferris, Baker, Watts, Incorporated, 7601 Lewinsville Road, Suite 450, McLean, Virginia 22102 or at such other place as shall be agreed upon by the Company and you, at 9:00 A.M. (prevailing Eastern time), either (i) on the fourth full business day after the effective date of the Registration Statement, or (ii) at such other time thereafter as you, and the Company shall determine (unless, in either case, postponed pursuant to Section 12 hereof) (such date and time of payment and delivery being herein called the "Closing Time") (the Closing Time and each Date of Delivery, if any, being sometimes referred to as a "Closing Date") but in no event later than August 31, 2003. In addition, in the event that any or all of the Option Shares are purchased by the Underwriters, payment of the purchase price for and delivery of the Option Shares shall be made at the offices of Ferris, Baker, Watts, Incorporated in the manner set forth above, or at such other

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place as you shall determine, on the Date of Delivery as specified in the notice from you to the Company. Payment for the Firm Shares and the Option Shares in immediately available United States funds shall be made by the order of the Company against delivery to you for the respective accounts of the Underwriters of the Shares to be purchased by them.

(d) The Shares to be purchased by the Underwriters shall be in such denominations and registered in such names as you may request in writing at least one full business day before the Closing Time or the Date of Delivery, as the case may be. The Shares will be made available at the offices of Ferris, Baker, Watts, Incorporated or at such other place as Ferris, Baker, Watts, Incorporated may designate for examination and packaging not later than 9:00 A.M. (prevailing Eastern time) on the business day prior to the Closing Time or the Date of Delivery, as the case may be.

Section 4. Certain Covenants of the Company and the Operating Partnership. The Company and the Operating Partnership covenant and agree with each Underwriter as follows:

(a) The Company will use its best efforts to cause the Registration Statement to become effective (if not yet effective at the date and time that this Agreement is executed and delivered by the parties hereto). If the Company elects to rely upon Rule 430A of the 1933 Act Regulations or the filing of the Prospectus is otherwise required under Rule 424(b) of the 1933 Act Regulations, and subject to the provisions of Section 4(b) of this Agreement, the Company will comply with the requirements of Rule 430A and will file the Prospectus, properly completed, pursuant to the applicable provisions of Rule 424(b), or a Term Sheet pursuant to and in accordance with Rule 434, within the time period prescribed. If the Company elects to rely upon Rule 462(b), the Company shall file a 462(b) Registration Statement with the Commission in compliance with Rule 462(b) by 10:00 A.M., prevailing Eastern time on the date after the date of this Agreement, and the Company shall at the time of filing either pay to the Commission the filing fee for the Rule 462(b) Registration Statement or give irrevocable instructions for the payment of such fee. The Company will notify you immediately and confirm the notice in writing, (i) when the Registration Statement, the 462(b) Registration Statement or any post-effective amendment to the Registration Statement, shall have become effective, or any supplement to the Prospectus or any amended Prospectus shall have been filed, (ii) of the receipt of any comments from the Commission, (iii) of any request by the Commission to amend the Registration Statement or the 462(b) Registration Statement or amend or supplement the Prospectus or for additional information, and (iv) of the issuance by the Commission of any stop order suspending the effectiveness of the Registration Statement or any 462(b) Registration Statement or of any order preventing or suspending the use of any Preliminary Prospectus, or of the suspension of the qualification of the Shares for offering or sale in

any jurisdiction, or of the institution or threat of any proceedings for any of such purposes. The Company will use every reasonable effort to prevent the issuance of any such stop order or of any order preventing or suspending such use and, if any such order is issued, use its reasonable efforts to obtain the withdrawal thereof at the earliest possible moment.

(b) The Company will not at any time file or make any amendment to the Registration Statement or any amendment or supplement (i) to the Prospectus, if the Company has not elected to rely upon Rule 430A, or (ii) if the Company has elected to rely upon Rule

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430A, to either the Prospectus included in the Registration Statement at the time it becomes effective or to the Prospectus filed in accordance with Rule 424(b) or any Term Sheet filed in accordance with Rule 434, or (iii) if the Company has elected to rely upon Rule 462(b), to any 462(b) Registration Statement, in any case if you shall not have previously been advised and furnished a copy thereof a reasonable time prior to the proposed filing, or if you or counsel for the Underwriters shall reasonably object to such amendment or supplement.

(c) The Company has furnished or will furnish to you, at the Company's expense, as soon as available, as many conformed copies of the Registration Statement as originally filed and of all amendments thereto, whether filed before or after the Registration Statement becomes effective, copies of all exhibits and documents filed therewith and copies of all consents and certificates of experts, as you may reasonably request. The copies of the Registration Statement and each amendment thereto furnished to the Underwriters will be identical to the electronically transmitted copies thereof filed with the Commission pursuant to EDGAR, except to the extent permitted by Regulation S-T.

(d) The Company will deliver to each Underwriter, at the Company's expense, from time to time, as many copies of each Preliminary Prospectus as such Underwriter may reasonably request, and the Company hereby consents to the use of such copies for purposes permitted by the 1933 Act and the 1933 Act Regulations. The Company will deliver to each Underwriter, at the Company's expense, as soon as the Registration Statement shall have become effective, and thereafter from time to time as requested during the period when the Prospectus is required to be delivered under the 1933 Act and the 1933 Act Regulations, such number of copies of the Prospectus (as supplemented or amended) as each Underwriter may reasonably request. The Preliminary Prospectus and Prospectus, and any supplements or amendments thereto furnished to the Underwriters will be identical to the electronically transmitted copies thereof filed with the Commission pursuant to EDGAR, except to the extent permitted by Regulation S-T.

(e) The Company will use its best efforts to comply with the 1933 Act and the 1933 Act Regulations so as to permit the completion of the distribution of the Shares as contemplated in this Agreement and in the Prospectus. In case you are required to deliver a prospectus within nine months after the time of issue of the Prospectus or any Term Sheet in connection with the offering or sale of the Shares and if at such time any event shall have occurred as a result of which the Prospectus or any Term Sheet as then amended or supplemented would include an untrue statement of a material fact or omit to state any material fact necessary in order to make the statements therein, in light of the circumstances under which they were made when such Prospectus or any Term Sheet is delivered, not misleading, or, if for any reason it shall be necessary during such period, in the opinion of counsel for the Underwriters or for the Company, to amend or supplement the Prospectus or any Term Sheet in order to comply with the 1933 Act or the 1933 Act Regulations, the Company will notify you and upon your request prepare promptly and furnish without charge to each Underwriter and to any dealer in securities as many copies as you may from time to time reasonably request of an amended Prospectus or any Term Sheet or a supplement to the Prospectus or any Term Sheet which will correct such statement or omission or effect such compliance. In case any Underwriter is required to deliver a prospectus in connection with sales of any of the Shares at any time nine months or more after the time of

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issue of the Prospectus or any Term Sheet, upon your request but at the expense of such Underwriter, the Company will prepare and deliver to such Underwriter as many copies as you may request of an amended or supplemented Prospectus or any Term Sheet complying with the requirements of Section 10(a)(3) of the 1933 Act.

(f) The Company will use its best efforts, in cooperation with you, to qualify the Shares for offering and sale under the applicable securities laws of such states and other jurisdictions as you may designate and to maintain such qualifications in effect for as long as may be necessary to complete the distribution of the Shares; provided, however, that the Company shall not be obligated to file any general consent to service of process or to qualify as a foreign entity in any jurisdiction in which it is not otherwise so subject. The Company will file such statements and reports as may be required by the laws of each jurisdiction in which the Shares have been qualified as above provided.

(g) The Company will use the net proceeds received by it from the sale

of the Shares in the manner specified in the Prospectus under the caption "Use of Proceeds."

(h) The Company will make generally available to its security holders as soon as practicable, but in any event not later than the end of the fiscal quarter first occurring after the first anniversary of the "effective date of the Registration Statement" (as defined in Rule 158(c) of the 1933 Act Regulations), an earnings statement (in reasonable detail but which need not be audited) complying with the provisions of Section 11(a) of the 1933 Act and Rule 158 of the 1933 Act Regulations and covering a period of at least 12 months beginning after the effective date of the Registration Statement.

(i) The Company, during the period when the Prospectus is required to be delivered under the 1933 Act or the 1934 Act, will file all documents required to be filed with the Commission pursuant to the 1934 Act within the time periods required by the 1934 Act and the rules and regulations of the Commission thereunder.

(j) During a period of 180 days from the date of the Prospectus, the Company will not, without your prior written consent (i) directly or indirectly, offer, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase or otherwise transfer or dispose of, any Common Share or securities convertible into or exercisable or exchangeable for shares of Common Stock or file any registration statement under the 1933 Act with respect to any of the foregoing, or (ii) enter into any swap or any other agreement or other transaction that transfers, in whole or in part, directly or indirectly, the economic consequence of ownership of the Common Stock, whether any such swap or transaction described in clause (i) or (ii) above is to be settled by delivery of shares of Common Stock or such other securities, in cash or otherwise. The foregoing sentence shall not apply to (A) any shares of Common Stock issued by the Company upon the exercise of an option or warrant or the conversion of a security described in the Prospectus, (B) any shares of Common Stock issued or options to purchase shares of Common Stock granted pursuant to the Company's 2003 Equity Incentive Plan, (C) any shares of Common Stock issued pursuant to any non-employee director stock plan or dividend reinvestment plan, warrant or the conversion of a security outstanding upon completion of the formation transactions described in the Prospectus

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or contributions to employee benefit plans in existence on the Closing Date; (D) any Units issued in exchange for the properties and any real property or interest in any real property acquired after the date hereof, or (E) any securities issued by the Company in connection with any merger or acquisition by the Company of securities or assets of a party that is not an affiliate of the Company.

(k) The Company will maintain a transfer agent and, if necessary under the jurisdiction of incorporation of the Company, a registrar (which may be the same entity as the transfer agent) for its shares of Common Stock.

(l) The Company will use its best efforts to maintain the listing of its Shares (including the Shares) on the Nasdaq National Market.

(m) The Company is familiar with the Investment Company Act of 1940, as amended, and the rules and regulations thereunder, and will in the future conduct its and the Operating Partnership's affairs, in such a manner so as to ensure that the Company and the Operating Partnership will not be an "investment company" within the meaning of the Investment Company Act of 1940 and the rules and regulations thereunder.

(n) The Company will not, and will use its best efforts to cause its officers, directors and affiliates not to, (i) take, directly or indirectly prior to the termination of the underwriting syndicate contemplated by this Agreement, any action designed to stabilize or manipulate the price of any security of the Company, or which may cause or result in, or which might in the future reasonably be expected to cause or result in, the stabilization or manipulation of the price of any security of the Company, to facilitate the sale or resale of any of the Shares, (ii) sell, bid for, purchase or pay anyone any compensation for soliciting purchases of the Shares or (iii) pay or agree to pay to any person any compensation for soliciting any order to purchase any other securities of the Company.

(o) If at any time during the 30-day period after the Registration Statement becomes effective, any publication or event relating to or affecting the Company shall occur as a result of which in your reasonable opinion the market price of the Common Stock has been or is likely to be materially affected (regardless of whether such publication or event necessitates a supplement or amendment of the Prospectus) and after written notice from you advising the Company to the effect set forth above, the Company agrees to forthwith prepare, consult with you concerning the substance of, and disseminate a press release or other public statement, reasonably satisfactory to you, responding to or commenting on such publication or event.

(p) The Company will file timely and accurate information with the

Commission in accordance with Rule 463 of the 1933 Act Regulations or any successor provision.

(q) The Company will supply you with copies of all correspondence to and from and all documents issued to and by the Commission or the Commission staff in connection with the registration of the Shares under the 1933 Act.

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(r) The Company shall provide the Underwriters and/or their counsel with copies of or access to all closing documents in respect of the purchase of each property as soon as practicable prior to the closing of the purchase of such property.

Section 5. [Intentionally Omitted]

Section 6. Payment of Expenses.

(a) The Company will pay or cause to be paid and bear all costs, fees and expenses incident to the performance of its obligations under this Agreement, including (i) the preparation, printing and filing of the Registration Statement (including financial statements and exhibits), as originally filed and as amended, the Preliminary Prospectuses and the Prospectus and any amendments or supplements thereto, and the cost of furnishing copies thereof to the Underwriters; (ii) the preparation, printing and distribution of this Agreement, any Agreement Among Underwriters, and Selected Dealer Agreement; (iii) the issuance and delivery of the Shares to the Underwriters, including any transfer taxes payable upon the sale of the Shares to the Underwriters (other than transfer taxes on resales by the Underwriters); (iv) the fees and disbursements of the Company's counsel and accountants; (v) the qualification of the Shares under the applicable securities laws in accordance with Section 4(e) hereof and any filing for review of the offering with the NASD, including filing fees and the reasonable fees and disbursements of counsel for the Underwriters in connection therewith; (vi) the transfer agent's and registrar's fees and all miscellaneous expenses referred to in Item 31 of the Registration Statement; (vii) costs related to travel and lodging incurred by the Company and its representatives relating to meetings with and presentations to prospective purchasers of the Shares and, with the prior approval of the Company, one half of the cost of any aircraft chartered in connection with the road show; and (viii) all other costs and expenses incident to the performance of the Company's and the Operating Partnership's obligations hereunder (including costs incurred in closing the purchase of the Option Shares, if any) that are not otherwise specifically provided for in this section. The Company, upon your request, will provide funds in advance for filing fees in connection with "blue sky" qualifications and the NASD.

(b) If the sale of Shares provided for herein is not consummated (other than as a result of a breach of this Agreement by one or more of the Underwriters), the Company and the Operating Partnership will reimburse the Underwriters on demand for all reasonable out-of-pocket expenses, including fifty percent (50%) of the fees and disbursements of Underwriters' counsel, reasonably incurred by the Underwriters in connection with the transactions contemplated by this Agreement.

(c) [Intentionally Omitted]

Section 7. Conditions of Underwriters' Obligations. The obligations of the Underwriters to purchase and pay for the Shares that they have severally agreed to purchase pursuant to this Agreement (whether Firm Shares at the Closing Time or, upon exercise of the

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option granted in Section 3, Option Shares on the Date of Delivery) are subject to the following conditions:

(a) The Registration Statement shall have become effective not later than 5:30 P.M., prevailing Eastern time, on the date of this Agreement or, with your consent, at a later time and date not later, however, than 5:30 P.M., prevailing Eastern time, on the first business day following the date hereof, or at such later time or on such later date as you may agree to in writing; as of such Closing Date the Registration Statement shall remain effective and no stop order suspending the effectiveness of the Registration Statement shall have been issued under the 1933 Act and no proceedings for that purpose shall have been instituted or shall be pending or, to your knowledge or the knowledge of the Company or the Operating Partnership, shall be contemplated by the Commission, and any request on the part of the Commission for additional information shall have been complied with to the reasonable satisfaction of counsel for the Underwriters. If the Company has elected to rely upon Rule 430A, a prospectus containing the Rule 430A Information shall have been filed with the Commission in accordance with Rule 424(b) (or a post-effective amendment providing such information shall have been filed and declared effective in accordance with the requirements of Rule 430A) or, if the Company has elected to rely on Rule 434, a Term Sheet shall have been filed with the Commission in accordance with Rule 424(b).

(b) You shall have received the favorable opinion, dated such Closing

Date, of Cooley Godward LLP, counsel for the Company, together with signed or reproduced copies of such opinions for each of the other Underwriters, in form and substance satisfactory to you and counsel for the Underwriters covering such matters as shall be customary for transactions of the nature contemplated by this Agreement. In addition, you shall have received the favorable opinion, dated such Closing Date, of Cooley Godward LLP, together with signed or reproduced copies of such opinion for each of the other Underwriters, in form and substance satisfactory to you and counsel for the Underwriters, as to the qualification of the Company as a REIT, the status of the Operating Partnership as a partnership, and the lack of status of the Operating Partnership as a publicly traded partnership, in each case for federal income tax purposes.

(c) You shall have received a favorable opinion from Bass, Berry & Sims PLC, counsel for the Underwriters, dated such Closing Date, with respect to the Registration Statement, the Prospectus and other related matters as the Underwriters may reasonably require, and the Company and the Operating Partnership shall have furnished to such counsel such documents as they reasonably request for the purpose of enabling them to pass upon such matters. In giving such opinion such counsel may assume, as to all matters governed by the laws of jurisdictions other than the federal law of the United States and the law of the State of Tennessee, that the laws of such jurisdictions are identical to the laws of the State of Tennessee. Such counsel may also state that, insofar as such opinion involves factual matters, they have relied, to the extent they deem proper, upon certificates of officers of the Company and its Subsidiaries and certificates of public officials.

(d) As of such Closing Date,

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(i) the Registration Statement, any 462(b) Registration Statement, and the Prospectus, as they may then be amended or supplemented, shall contain all statements that are required to be stated therein under the 1933 Act and the 1933 Act Regulations and in all respects shall conform to the requirements of the 1933 Act and the 1933 Act Regulations, the Company shall have complied in all respects with Rule 430A (if it shall have elected to rely thereon) and neither the Registration Statement, any 462(b) Registration Statement nor the Prospectus, as they may then be amended or supplemented, shall contain an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading;

(ii) there shall not have been any change in the capital stock or long-term debt of the Company or the Operating Partnership or any change, or any development involving a prospective change, in or affecting the business, general affairs, management, condition (financial or otherwise), stockholders' equity, results of operations, properties or prospects of the Company or the Operating Partnership, otherwise than as set forth in the Prospectus, the effect of which is, in your judgment, so material and adverse as to make it impracticable or inadvisable to proceed with the completion of the public offering of the Shares;

(iii) no action, suit or proceeding at law or in equity before or by any federal, state or other commission, court, board or administrative agency shall be pending or, to the Company's knowledge, threatened against the Company or the Operating Partnership that would be required to be set forth in the Prospectus, other than as set forth therein, wherein an unfavorable decision, ruling or finding would have a Material Adverse Effect;

(iv) the Company and the Operating Partnership shall have complied with all agreements and satisfied all conditions contained herein in all material respects on their respective parts to be performed or satisfied at or prior to such Closing Date; and

(v) the representations and warranties of the Company and the Operating Partnership set forth in Section 1 shall be accurate in all material respects as though expressly made at and as of such Closing Date. You shall have received certificates, dated as of such Closing Date, executed by the President and the Chief Financial Officer of the Company to such effect and with respect to the following additional matters:

(A) the Registration Statement has become effective under the 1933 Act and no stop order suspending the effectiveness of the Registration Statement or preventing or suspending the use of the Prospectus has been issued, and no proceedings for that purpose have been instituted or are pending or, to their knowledge, threatened under the 1933 Act;

(B) they have reviewed the Registration Statement,

any 462(b) Registration Statement and the Prospectus and when the Registration Statement and any 462(b) Registration Statement became effective and at all times subsequent thereto up to the delivery of such certificate, the Registration

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Statement, any 462(b) Registration Statement and the Prospectus and any amendments or supplements thereto contained all statements and information required to be included therein or necessary to make the statements therein in light of the circumstances in which they were made, not misleading and neither the Registration Statement, any 462(b) Registration Statement, the Prospectus nor any amendment or supplement thereto included any untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary in order to make the statements therein not misleading, and, since the effective date of the Registration Statement, there has occurred no event required to be set forth in an amended or supplemented Prospectus that has not been so set forth;

(C) all agreements herein to be performed by the Company and the Operating Partnership, on or prior to such Closing Date have been duly performed; and

(D) since the date of this Agreement or since the respective dates as of which information is given in the Prospectus, the Company has not experienced any event or circumstance that would have a Material Adverse Effect.

(e) At the time of execution of this Agreement, you shall have received from PricewaterhouseCoopers LLP a letter addressed to you and dated the date hereof, in form and substance satisfactory to you and your counsel, together with signed or reproduced copies of such letter(s) for each of the other Underwriters, (i) confirming that they are independent public accountants with respect to the Company and the Operating Partnership within the meaning of the 1933 Act and the 1933 Act Regulations, and are in compliance with the applicable requirements relating to the qualification of accountants under Rule 2-01 of Regulation S-X of the Commission, (ii) stating that, in their opinion, the financial statements and any supplementary financial information and schedules included in the Registration Statement and covered by their opinion therein comply as to form in all material respects with the applicable accounting requirements of the 1933 Act, the 1933 Act Regulations and applicable Staff Accounting Bulletins and other official accounting pronouncements of the Commission, and (iii) containing such other statements and information of the type ordinarily included in accountants' "comfort letters" to underwriters with respect to the financial statements and certain financial and other information contained in the Registration Statement and the Prospectus.

(f) With respect to the letter of PricewaterhouseCoopers LLP delivered to you and referred to in the preceding paragraph (e) (the "PricewaterhouseCoopers Initial Letter"), you shall have received from PricewaterhouseCoopers LLP a letter of such accountants, in form and substance satisfactory to you, addressed to the Underwriters and dated as of such Closing Date, together with signed or reproduced copies of such letter for each of the other Underwriters, to the effect that they reaffirm all statements, conclusions and findings set forth in the PricewaterhouseCoopers Initial Letter; except that the specified date referred to shall be a date not more than three business days prior to the Closing Time.

(g) Subsequent to the execution and delivery of this Agreement, there shall not have occurred any of the following: (i) trading in securities generally on the New York Stock

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Exchange or the American Stock Exchange or in the over-the-counter market, or trading in any securities of the Company on any exchange or in the over-the-counter market, shall have been suspended or the settlement of such trading generally shall have been materially disrupted or minimum prices shall have been established on any such exchange or such market by the Commission, by such exchange or by any other regulatory body or governmental authority having jurisdiction, (ii) a banking moratorium shall have been declared by federal or state authorities, (iii) the United States shall have become engaged in hostilities, there shall have been an escalation in hostilities involving the United States or there shall have been a declaration of a national emergency or war by the United States which, in either case, is such as to make it, in your reasonable judgment, impracticable or inadvisable to proceed with the completion of the public offering of the shares or (iv) there shall have occurred such a material adverse change in general economic, political or financial conditions, including without limitation as a result of terrorist activities after the date hereof, or the effect of international conditions on the financial markets in the United States, which, in either case, shall be such as to make it, in your reasonable judgment, impracticable or inadvisable to proceed with the completion of the public offering the Shares.

(h) As of such Closing Date, counsel for the Underwriters shall have been furnished with all such documents, certificates and opinions as they may reasonably request for the purpose of enabling them to pass upon the issuance and sale of the Shares as contemplated in this Agreement and the matters referred to in Section 7(c) and in order to evidence the accuracy and completeness of any of the representations and warranties or statements of the Company and the Operating Partnership, the performance of any of the covenants of the Company and the Operating Partnership, or the fulfillment of any of the conditions herein contained; and all proceedings taken by the Company at or prior to such Closing Date in connection with the authorization, issuance and sale of the Shares as contemplated in this Agreement shall be reasonably satisfactory in form and substance to you and to counsel for the Underwriters. The Company will furnish you with such number of conformed copies of such opinion, certificates, letters and documents as you shall request.

(i) The NASD, upon review of the terms of the public offering of the Shares, shall not have objected to such offering, such terms or the Underwriters' participation in the same.

(j) The Firm Shares and the Option Shares, if any, shall have been approved for listing on the Nasdaq National Market upon official notice of the issuance, sale and evidence of satisfactory distribution thereof pursuant to this Agreement.

(k) Each person identified in the Prospectus as a person required to sign an agreement not to sell shares of Common Stock after the date hereof shall have signed and delivered such agreement, in form and substance reasonably satisfactory to the Underwriters and their counsel.

If any of the conditions specified in this Section 7 shall not have been fulfilled when and as required by this Agreement to be fulfilled, this Agreement may be terminated by you on notice to the Company at any time at or prior to such Closing Date, and such termination shall be

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without liability of any party to any other party. Notwithstanding any such termination, the provisions of Section 9 shall remain in effect and shall survive the termination of this Agreement.

Section 8. [Intentionally Omitted]

Section 9. Indemnification and Contribution.

(a) The Company and the Operating Partnership, jointly and severally, agree to indemnify and hold harmless each Underwriter, its partners, directors and officers and each person, if any, who controls any Underwriter within the meaning of Section 15 of the 1933 Act or Section 20 of the Exchange Act, and the successors and assigns of all such persons, from and against any losses, claims, damages or liabilities, joint or several, to which any such Underwriter or any such other person may become subject under the 1933 Act, the Exchange Act, common law or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement, the Prospectus, or any amendment or supplement thereto, or arise out of or are based upon the omission or alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances in which they were made, not misleading, and will reimburse each Underwriter and each such partner, director, officer, employee and controlling person for any legal or other expenses reasonably incurred by such Underwriter, partner, director, officer, employee or controlling person in connection with investigating or defending any such loss, claim, damage, liability or action; provided, however, that the Company and the Operating Partnership shall not be liable in any such case to the extent that any such loss, claim, damage or liability arises out of or is based upon an untrue statement or alleged untrue statement or omission or alleged omission made in the Registration Statement or the Prospectus, or such amendment or supplement, in reliance upon and in conformity with information furnished to the Company or the Operating Partnership by you or by any Underwriter through you expressly for use therein, it being understood and agreed that the only such information furnished by you or by any Underwriter through you consists of the information specified in Section 9(h) below; provided, further, that the Company and the Operating Partnership will not be liable for any such losses, claims, damages, or liabilities arising from the sale of the Shares to any person if a copy of the Prospectus (as first filed pursuant to Rule 424(b)) or the Prospectus as amended or supplemented by all amendments or supplements thereto which has been furnished to the Underwriters (within a reasonable amount of time prior to such sale) shall not have been sent, mailed or given to such person, at or prior to the written confirmation of the sale of such Shares to such person, but only if and to the extent that such Prospectus, if so sent or delivered, would have cured the defect giving rise to, and been a complete defense against



the person asserting, such loss, claim, damage or liability. This indemnity agreement shall be in addition to any liabilities that the Company and the Operating Partnership may otherwise have.

(b) [Intentionally Omitted.]

(c) Each Underwriter, severally but not jointly, will indemnify and hold harmless the Company and the Operating Partnership against any losses, claims, damages or liabilities to

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which the Company or the Operating Partnership may become subject under the 1933 Act, the Exchange Act, common law or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of or are based upon any untrue statement or alleged untrue statement of any material fact contained in the Registration Statement, the Prospectus, or any amendment or supplement thereto, or arise out of or are based upon the omission or the alleged omission to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances in which they were made, not misleading, in each case to the extent, but only to the extent, that such untrue statement or alleged untrue statement or omission or alleged omission was made in the Registration Statement or the Prospectus, or such amendment or supplement, or any Blue Sky Application, in reliance upon and in conformity with information furnished to the Company by such Underwriter expressly for use therein, it being understood and agreed that the only such information furnished by any Underwriter consists of the information specified in Section 9(h) below, and will reimburse the Company and the Operating Partnership for any legal or other expenses reasonably incurred by the Company or the Operating Partnership in connection with investigating or defending any such loss, claim, damage, liability or action. This indemnity agreement shall be in addition to any liabilities that the Underwriters may otherwise have.

The indemnity agreement in this Section 9(c) shall extend upon the same terms and conditions to, and shall inure to the benefit of, each director of the Company, each officer of the Company who signed the Registration Statement, and each person, if any, who controls the Company within the meaning of Section 15 of the 1933 Act or Section 20 of the Exchange Act, to the same extent as such agreement applies to the Company.

(d) Within ten days after receipt by an indemnified party under subsection (a) or (c) above of notice of commencement of any action, such indemnified party shall, if a claim in respect thereof is to be made against the indemnifying party under such subsection, notify the indemnifying party in writing of the commencement thereof; no indemnification provided in Section 9(a) or 9(c) shall be available to any party who shall fail to give notice as provided in this Section 9(d) if the party to whom notice was not given was unaware of the proceeding to which such notice would have related and was prejudiced by the failure to give such notice, but the omission so to notify the indemnifying party will not relieve the indemnifying party from any liability that it may have to any indemnified party otherwise than under this Section 9. In case any such action shall be brought against any indemnified party and it shall notify the indemnifying party of the commencement thereof, the indemnifying party shall be entitled to participate therein, and, to the extent that it shall wish, jointly with any other indemnifying party, similarly notified, to assume the defense thereof, with counsel satisfactory to such indemnified party, and after notice from the indemnifying party to such indemnified party of its election so to assume the defense thereof the indemnifying party shall not be liable to such indemnified party for any legal or other expenses, other than reasonable costs of investigation, subsequently incurred by such indemnified party in connection with the defense thereof. The indemnified party shall have the right to employ its own counsel in any such action, but the fees and expenses of such counsel shall be at the expense of such indemnified party unless (i) the employment of counsel by such indemnified party has been authorized by the indemnifying party, (ii) the defendants in any such action include both the indemnified party and the indemnifying party and the indemnified party shall have reasonably concluded that there may be a conflict of interest

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between the indemnifying party and the indemnified party in the conduct of the defense of such action (in which case the indemnifying party shall not have the right to direct the defense of such action on behalf of the indemnified party) or (iii) the indemnifying party shall not in fact have employed counsel to assume the defense of such action, in any of which events such fees and expenses shall be borne by the indemnifying party provided that the indemnifying party shall not be liable for more than one separate counsel (together with any local counsel). The indemnifying party shall not be liable for any settlement of any proceeding effected without its written consent, but if settled with such consent or if there be a final judgment for the plaintiff, the indemnifying party agrees to indemnify the indemnified party from and against any loss or liability by reason of such settlement or judgment.

(e) [Intentionally Omitted]

(f) In order to provide for just and equitable contribution in circumstances under which the indemnity provided for in this Section 9 is for any reason judicially determined (by the entry of a final judgment or decree by a court of competent jurisdiction and the expiration of time to appeal or the denial of the last right of appeal) to be unenforceable by the indemnified parties although applicable in accordance with its terms, the Company, the Operating Partnership and the Underwriters shall contribute to the aggregate losses, liabilities, claims, damages and expenses of the nature contemplated by such indemnity incurred by the Company, the Operating Partnership and one or more of the Underwriters, as incurred, in such proportions that (i) the Underwriters are responsible pro rata for that portion represented by the underwriting discount appearing on the cover page of the Prospectus bears to the public offering price (before deducting expenses) appearing thereon, and (ii) the Company and the Operating Partnership are responsible for the balance; provided, however, that no person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the 1933 Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation; provided, further, that if the allocation provided above is not permitted by applicable law, the Company, the Operating Partnership and the Underwriters shall contribute to the aggregate losses in such proportion as is appropriate to reflect not only the relative benefits referred to above but also the relative fault of the Company, the Operating Partnership and the Underwriters in connection with the statements or omissions which resulted in such losses, claims, damages or liabilities, as well as any other relevant equitable considerations. Relative fault shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information supplied by the Company, by the Operating Partnership or by the Underwriters and the parties' relative intent, knowledge, access to information and opportunity to correct or prevent such statement or omission. The amount paid or payable by a party as a result of the losses, claims, damages or liabilities referred to above shall be deemed to include any legal or other fees or expenses reasonably incurred by such party in connection with investigating or defending any such action or claim. Notwithstanding the provisions of this subsection (f), no Underwriter shall be required to contribute any amount in excess of the amount by which the total price at which the Shares underwritten by it and distributed to the public were offered to the public exceeds the amount of any damages which such Underwriter has otherwise been required to pay by reason of such untrue or alleged untrue statement or omission or alleged omission. For purposes of this Section 9(f), the partners, directors, officers and employees and each person, if any, who controls an

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Underwriter within the meaning of Section 15 of the 1933 Act or Section 20 of the Exchange Act shall have the same rights to contribution as such Underwriter, and each director of the Company, each officer of the Company who signed the Registration Statement and each person, if any, who controls the Company within the meaning of Section 15 of the 1933 Act or Section 20 of the Exchange Act shall have the same rights to contribution as the Company.

(g) [Intentionally Omitted]

(h) For purposes of this Section 9, the Underwriters severally confirm, and the Company and the Operating Partnership acknowledge, that the second paragraph below the pricing table on the prospectus cover, the second and fifth paragraphs under the caption "Underwriting" and the information set forth under the headings "Stabilization, Short Positions and Penalty Bids" and "Electronic Distribution" under the caption "Underwriting" in the Prospectus constitutes the only information furnished by the Underwriters to the Company for inclusion in the Prospectus or the Registration Statement.

Section 10. Representations and Agreements to Survive Delivery. The representations, warranties, covenants, indemnities, agreements and other statements of the Company and the Operating Partnership set forth in or made pursuant to this Agreement will remain operative and in full force and effect regardless of any investigation made by or on behalf of the Company, the Operating Partnership, any Underwriter or any representative, officer, director or any controlling person with respect to an Underwriter, the Company, or the Operating Partnership, and will survive delivery of and payment for the Shares or termination of this Agreement.

Section 11. Effective Date of Agreement and Termination.

(a) This Agreement shall become effective (i) if at the time of execution of this Agreement the Registration Statement has not become effective, upon the effectiveness of the Registration Statement, or (ii) if at the time of execution of this Agreement, the Registration Statement has been declared effective, immediately upon execution of this Agreement.

(b) You may terminate this Agreement by notice to the Company at any time at or prior to the Closing Date in accordance with the last paragraph of Section 7 of this Agreement.

(c) If this Agreement is terminated pursuant to this Section 11, such

termination shall be without liability of any party to any other party, except that, notwithstanding any such termination, (i) the provisions of Section 6 and Section 9 shall remain in effect, and (ii) if any Shares have been purchased hereunder, the representations and warranties in Section 1 and all obligations under Section 4 shall also remain in effect.

Section 12. Default by One or More of the Underwriters.

(a) If any Underwriter shall default in its obligation to purchase the Firm Shares which it has agreed to purchase hereunder, you may in your discretion arrange for you or another party or other parties to purchase such Firm Shares on the terms contained herein. If within 36 hours after such default by any Underwriter you do not arrange for the purchase of such Firm

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Shares, then the Company shall be entitled to a further period of 36 hours within which to procure another party or other parties satisfactory to you to purchase such Firm Shares on such terms. In the event that, within the respective prescribed periods, you notify the Company that you have so arranged for the purchase of such Firm Shares, or the Company notifies you that it has so arranged for the purchase of such Firm Shares, you or the Company shall have the right to postpone the Closing Time for a period of not more than seven days in order to effect whatever changes may thereby be made necessary in the Registration Statement or the Prospectus, or in any other documents or arrangements, and the Company agrees to file promptly any amendments to the Registration Statement or the Prospectus which in your opinion may thereby be made necessary. The term "Underwriter" as used in this Agreement shall include any persons substituted under this Section 12 with like effect as if such person had originally been a party to this Agreement with respect to such Firm Shares.

(b) If, after giving effect to any arrangements for the purchase of the Firm Shares of a defaulting Underwriter or Underwriters made by you or the Company as provided in subsection (a) above, the aggregate number of Firm Shares which remains unpurchased does not exceed 10% of the Firm Shares, then the Company shall have the right to require each non-defaulting Underwriter to purchase the Firm Shares which such Underwriter agreed to purchase hereunder and, in addition, to require each non-defaulting Underwriter to purchase its pro rata share (based on the number of Firm Shares which such Underwriter agreed to purchase hereunder) of the Firm Shares of such defaulting Underwriter or Underwriters for which such arrangements have not been made.

(c) If, after giving effect to any arrangements for the purchase of the Firm Shares of a defaulting Underwriter or Underwriters made by you or the Company as provided in subsection (a) above, the number of Firm Shares which remains unpurchased exceeds 10% of the Firm Shares, or if the Company shall not exercise the right described in subsection (b) above to require non-defaulting Underwriters to purchase Firm Shares of a defaulting Underwriter or Underwriters, then this Agreement shall thereupon terminate, without liability on the part of any non-defaulting Underwriter or the Company except for the expenses to be borne by the Company, and the Underwriters as provided in Section 6 hereof and the indemnity and contribution agreements in Section 9 hereof.

(d) Nothing herein shall relieve a defaulting Underwriter from liability for its default.

Section 13. Default by the Company. If the Company shall fail at the Closing Time to sell and deliver the respective aggregate number of Firm Shares that it is obligated to sell, then this Agreement shall terminate without any liability on the part of any non-defaulting party, except to the extent provided in Section 6 and except that the provisions of Section 9 shall remain in effect.

Section 14. Notices. All notices and other communications under this Agreement shall be in writing and shall be deemed to have been duly given if mailed, delivered or transmitted by any standard form of telecommunication. Notices to the Underwriters shall be directed c/o Ferris, Baker Watts, Incorporated, 7601 Lewinsville Road, Suite 450, McLean, Virginia 22102, Attention: Mr. Mark O. Decker, Sr., Senior Vice President (with a copy sent in the same manner

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to Bass, Berry & Sims PLC, 100 Peabody Place, Suite 900, Memphis, Tennessee 38103, Attention: John A. Good, Esq.); and notices to the Company or the Operating Partnership shall be directed to Gladstone Commercial Corporation, 1750 Tysons Blvd., Fourth Floor, McLean, Virginia 22102, Attention: David Gladstone, Chairman and Chief Executive Officer (with a copy sent in the same manner to Cooley Godward LLP, One Freedom Square, Reston Town Center, 11951 Freedom Drive, Reston, Virginia 20190, Attention: Thomas R. Salley, Esq.). Each notice hereunder shall be effective upon receipt by the party to which it is addressed.

Section 15. Parties. This Agreement is made solely for the benefit of the Underwriters, the Company and the Operating Partnership and, to the extent so provided, the partners, directors, directors and employees of the Underwriters

and any person controlling any of the Underwriters, the directors of the Company, the officers of the Company who have signed the Registration Statement and any person controlling the Company, and their respective executors, administrators, successors and assigns and, subject to the provisions of Section 12, no other person shall acquire or have any right under or by virtue of this Agreement. The term "successors and assigns" shall not include any purchaser, as such purchaser, from any of the several Underwriters of the Shares.

Section 16. Governing Law and Time. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Maryland. Specified time of the day refers to United States Eastern Time, unless otherwise specified.

Section 17. Counterparts. This Agreement may be executed in any number of counterparts and when a counterpart has been executed by each party, all such counterparts taken together shall constitute one and the same agreement.

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If the foregoing is in accordance with your understanding of our agreement, please sign and return to us a counterpart hereof, whereupon this instrument will become a binding agreement among the Company, and the several Underwriters in accordance with its terms.

Very truly yours,

Gladstone Commercial Corporation

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Gladstone Commercial Limited Partnership

By: Gladstone Commercial Corporation  
Its General Partner

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Ferris, Baker Watts, Incorporated  
Jefferies & Company, Inc.  
J.J.B. Hilliard, W.L. Lyons, Inc.  
Stifel, Nicolaus & Company, Incorporated

By: Ferris, Baker Watts, Incorporated  
As representatives of the underwriters  
listed above

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

<TABLE>	<CAPTION>	Number of Shares
Name	----	-----
<S>	<C>	
Ferris, Baker Watts, Incorporated.....		
Jefferies & Company, Inc. ....		
J.J.B. Hilliard, W.L. Lyons, Inc.....		
Stifel, Nicolaus & Company, Incorporated.....		
Total.....		5,500,000

SCHEDULE I

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SCHEDULE II

LIST OF SUBSIDIARIES

Gladstone Commercial Partners, LLC

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## AMENDED AND RESTATED INVESTMENT ADVISORY AGREEMENT

THIS AMENDED AND RESTATED INVESTMENT ADVISORY AGREEMENT (this "AGREEMENT") is entered into and made effective as of the 21st day of July 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.

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) and 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 2.0% 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.

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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.

6.

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: /s/ DAVID GLADSTONE

-----  
David Gladstone  
Chairman of the Board and CEO

GLADSTONE MANAGEMENT CORPORATION

By: /s/ TERRY BRUBAKER

-----  
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

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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

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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: \_\_\_\_\_



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,

GLADSTONE COMMERCIAL CORPORATION

FIRST AMENDMENT

TO  
2003 EQUITY INCENTIVE PLAN

RECITALS

A. On June 10, 2003, the Board of Directors and stockholders of GLADSTONE COMMERCIAL CORPORATION, a Maryland corporation (the "COMPANY"), adopted the 2003 Equity Incentive Plan (the "PLAN").

B. By action of the Board of Directors and stockholders on July 17, 2003, the Company adopted the following amendment to the Plan:

AMENDMENT

1. Section 4(a) of the Plan shall be amended and restated in its entirety to read as follows:

(A) SHARE RESERVE. Subject to the provisions of Section 11(a) relating to Capitalization Adjustments, the capital stock that may be issued pursuant to Stock Awards shall not exceed in the aggregate seven hundred fifty nine thousand (759,000).

2. Except as set forth in this First Amendment, the Plan shall be unaffected hereby and shall remain in full force and effect.

\* \* \*

I hereby certify that the foregoing amendment to the Plan was duly adopted by the Board of Directors and stockholders of Gladstone Commercial Corporation on July 17, 2003.

Executed on this 17th day of July, 2003.

/s/ Terry L. Brubaker

-----  
Terry L. Brubaker, COO and Secretary

AGREEMENT OF LIMITED PARTNERSHIP  
OF  
GLADSTONE COMMERCIAL LIMITED PARTNERSHIP

JULY 17, 2003

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AGREEMENT OF LIMITED PARTNERSHIP  
OF  
GLADSTONE COMMERCIAL LIMITED PARTNERSHIP

JULY 17, 2003

This Agreement of Limited Partnership (this "AGREEMENT") is entered into effective as of this 17th day of July 2003, by and among Gladstone Commercial Corporation, a Maryland corporation (the "GENERAL PARTNER"), Gladstone Commercial Partners, LLC, a Delaware limited liability company (the "ORIGINAL LIMITED PARTNER"), and the Limited Partner(s) set forth or which may, in the future, be set forth on Exhibit A hereto, as amended from time to time, with respect to Gladstone Commercial Limited Partnership (the "PARTNERSHIP"), a limited partnership formed under the laws of the State of Delaware, pursuant to a Certificate of Limited Partnership filed with the Office of the Secretary of State of the State of Delaware effective as of May 28, 2003.

RECITALS

WHEREAS, the parties hereto desire to enter into this Agreement in order to set forth the terms and conditions under which the Partnership will be operated as



well as the rights, obligations, and limitations of the General Partner and the Limited Partners with respect to each other and the Partnership as a whole;

NOW, THEREFORE, in consideration of the foregoing, of mutual covenants between the parties hereto, and of other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged by the parties, the parties hereto agree as follows:

AGREEMENT

ARTICLE 1

DEFINED TERMS

The following defined terms used in this Agreement shall have the meanings specified below:

"ACT" means the Delaware Revised Uniform Limited Partnership Act, as it may be amended from time to time.

"ADDITIONAL FUNDS" has the meaning set forth in Section 4.3 hereof.

"ADDITIONAL LIMITED PARTNER" means a Person admitted to the Partnership as a Limited Partner pursuant to Section 4.2 hereof and who is shown as such on the books and records of the Partnership.

"ADDITIONAL SECURITIES" means any additional REIT Shares (other than REIT Shares issued in connection with an exchange pursuant to Section 8.5 hereof) or rights, options, warrants or convertible or exchangeable securities containing the right to subscribe for or purchase REIT Shares, as set forth in Section 4.2(a) (ii).

"ADMINISTRATIVE EXPENSES" means (i) all administrative and operating costs and expenses incurred by the Partnership, (ii) those administrative costs and expenses of the General Partner, including any salaries or other payments to directors, officers or employees of the General Partner, and any accounting and legal expenses of the General Partner, which expenses, the Partners have agreed, are expenses of the Partnership and not the General Partner, and (iii) to the extent not included in clause (ii) above, REIT Expenses; provided, however, that Administrative Expenses shall not include any administrative costs and expenses incurred by the General Partner that are attributable to Properties or partnership interests in a Subsidiary Partnership that are owned by the General Partner directly.

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"ADVISER" or "ADVISERS" means the Person or Persons, if any, appointed, employed or contracted with by the General Partner pursuant to its Articles of Incorporation and responsible for directing or performing the day-to-day business affairs of the General Partner, including any Person to whom the Adviser subcontracts all or substantially all of such functions.

"AFFILIATE" or "AFFILIATED" means, with respect to any Person, (i) any Person directly or indirectly owning, controlling or holding, with the power to vote, 10% or more of the outstanding voting securities of such other Person; (ii) any Person 10% or more of whose outstanding voting securities are directly or indirectly owned, controlled or held, with the power to vote, by such other Person; (iii) any Person directly or indirectly controlling, controlled by or under common control with such other Person; (iv) any executive officer, director, trustee or general partner of such other Person; and (v) any legal entity for which such Person acts as an executive officer, director, trustee or general partner.

"AGREED VALUE" means (i) the fair market value of a Partner's non-cash Capital Contribution as of the date of contribution as agreed to by such Partner and the General Partner as of the date of contribution as set forth on Exhibit A hereto, as it may be amended from time to time, or (ii) in the case of any contribution or distribution of property other than cash not set forth on Exhibit A, the fair market value of such property as determined by the General Partner at the time such property is contributed or distributed, reduced by liabilities either assumed by the Partnership or Partner upon such contribution or distribution or to which such property is subject when the property is contributed or distributed.

"AGREEMENT" means this Agreement of Limited Partnership, as it may be amended or restated from time to time.

"ARTICLES OF INCORPORATION" means the Articles of Incorporation of the General Partner filed with the Maryland State Department of Assessments and Taxation, as amended or restated from time to time.

"BOARD OF DIRECTORS" means the Board of Directors of the General Partner.

"CAPITAL ACCOUNT" has the meaning provided in Section 4.4 hereof.

"CAPITAL CONTRIBUTION" means the total amount of cash, cash equivalents, and the Agreed Value of any Property or other asset contributed or agreed to be contributed, as the context requires, to the Partnership by each Partner pursuant to the terms of the Agreement. Any reference to the Capital Contribution of a Partner shall include the Capital Contribution made by a predecessor holder of the Partnership Interest of such Partner.

"CASH AMOUNT" means an amount of cash equal to the Value of the REIT Shares Amount on the date of receipt by the General Partner of an Exchange Notice.

"CERTIFICATE" means any instrument or document that is required under the laws of the State of Delaware, or any other jurisdiction in which the Partnership conducts business, to be signed and sworn to by the Partners of the Partnership (either by themselves or pursuant to the power-of-attorney granted to the General Partner in Section 8.2 hereof) and filed for recording in the appropriate public offices within the State of Delaware or such other jurisdiction to perfect or maintain the Partnership as a limited partnership, to effect the admission, withdrawal, or substitution of any Partner from or to the Partnership, or to protect the limited liability of the Limited Partners as limited partners under the laws of the State of Delaware or such other jurisdiction.

"CODE" means the Internal Revenue Code of 1986, as amended, and as hereafter amended from time to time. Reference to any particular provision of the Code shall mean that provision in the Code at the date hereof and any successor provision of the Code.

"COMMISSION" means the U.S. Securities and Exchange Commission.

"COMMON UNITS" means Partnership Units issued by the Partnership to the General Partner or its Subsidiaries in connection with the issuance of REIT Shares.

"COMPETENT INDEPENDENT EXPERT" means a Person with no material current or prior business or personal relationship with the General Partner or the Partnership who is engaged to a substantial extent in the business of rendering opinions regarding the value of assets of the type held by the Partnership and who is qualified to perform

such work. Membership in a nationally recognized appraisal society such as the American Institute of Real Estate Appraisers or the Society of Real Estate Appraisers shall be conclusive evidence of such qualification.

"CONVERSION FACTOR" means 1.0, provided, that in the event that the General Partner (i) declares or pays a dividend on its outstanding REIT Shares in REIT Shares or makes a distribution to all holders of its outstanding REIT Shares in REIT Shares, (ii) subdivides its outstanding REIT Shares, or (iii) combines its outstanding REIT Shares into a smaller number of REIT Shares, the Conversion Factor shall be adjusted by multiplying the Conversion Factor by a fraction, the numerator of which shall be the number of REIT Shares issued and outstanding on the record date for such dividend, distribution, subdivision or combination (assuming for such purposes that such dividend, distribution, subdivision or combination has occurred as of such time), and the denominator of which shall be the actual number of REIT Shares (determined without the above assumption) issued and outstanding on such date, and provided further, that in the event that an entity other than an Affiliate of the General Partner shall become General Partner pursuant to any merger, consolidation or combination of the General Partner with or into another entity (the "SUCCESSOR ENTITY"), the Conversion Factor shall be adjusted by multiplying the Conversion Factor by the number of shares of the Successor Entity into which one REIT Share is converted pursuant to such merger, consolidation or combination, determined as of the date of such merger, consolidation or combination. Any adjustment to the Conversion Factor shall become effective immediately after the effective date of such event retroactive to the record date, if any, for such event; provided, however, that if the General Partner receives an Exchange Notice after the record date, but prior to the effective date of such dividend, distribution, subdivision or combination, the Conversion Factor shall be determined as if the General Partner had received the Exchange Notice immediately prior to the record date for such dividend, distribution, subdivision or combination.

"DISSENTING LIMITED PARTNER" has the meaning provided in Section 12.3(a) hereof.

"EVENT OF BANKRUPTCY" as to any Person means (i) the filing of a petition for relief as to such Person as debtor or bankrupt under the Bankruptcy Code of 1978

or similar provision of law of any jurisdiction (except if such petition is contested by such Person and has been dismissed within 90 days); (ii) the insolvency or bankruptcy of such Person as finally determined by a court proceeding; (iii) the filing by such Person of a petition or application to accomplish the same or for the appointment of a receiver or a trustee for such Person or a substantial part of his assets; and (iv) the commencement of any proceedings relating to such Person as a debtor under any other reorganization, arrangement, insolvency, adjustment of debt or liquidation law of any jurisdiction, whether now in existence or hereinafter in effect, either by such Person or by another, provided, that if such proceeding is commenced by another, such Person indicates his approval of such proceeding, consents thereto or acquiesces therein, or such proceeding is contested by such Person and has not been finally dismissed within 90 days.

"EXCHANGE AMOUNT" means either the Cash Amount or the REIT Shares Amount, as selected by the General Partner in its sole and absolute discretion pursuant to Section 8.5(b) hereof.

"EXCHANGE NOTICE" means a Notice of Exercise of Exchange Right, as defined in Section 8.5(a) hereof and substantially in the form of Exhibit B hereto.

"EXCHANGE RIGHT" has the meaning provided in Section 8.5(a) hereof.

"EXCHANGING PARTNER" has the meaning provided in Section 8.5(a) hereof.

"GENERAL PARTNER" means Gladstone Commercial Corporation, a Maryland corporation, and any Person who becomes a substitute or additional General Partner as provided herein, and any successors thereto.

"GENERAL PARTNERSHIP INTEREST" means a Partnership Interest held by the General Partner that is a general partnership interest.

"GP CAPITAL" means the aggregate of Capital Contributions of cash made by the General Partner in accordance with Sections 4.1 and 4.2 hereof.

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"GP MINIMUM RETURN" means such amount as may be necessary or required to allow the General Partner to meet its distribution requirement for qualification as a REIT as set forth in Section 857 of the Code and to avoid any federal income or excise tax liability imposed by the Code.

"INDEMNITEE" means (i) any Person made a party to a proceeding by reason of its status as the General Partner, the Adviser or a director, officer or employee of the General Partner, the Adviser or the Partnership, and (ii) such other Persons (including Affiliates of the General Partner or the Partnership) as the General Partner may designate from time to time, in its sole and absolute discretion.

"INDEPENDENT DIRECTOR" means a director of the General Partner who is not on the date of determination (i) an officer or employee of the General Partner or the Adviser or any of their respective Affiliates or (ii) a lessee of any Property.

"JOINT VENTURE" means any joint venture or partnership arrangement in which the Partnership is a co-venturer or general partner established to acquire or hold Properties, Mortgages or other investments of the General Partner.

"LIMITED PARTNER" means the Original Limited Partner, any Person named as a Limited Partner on Exhibit A attached hereto, and any Person who becomes a Substitute or Additional Limited Partner in such person's capacity as a Limited Partner in the Partnership.

"LIMITED PARTNERSHIP INTEREST" means the ownership interest of a Limited Partner in the Partnership at any particular time, including the right of such Limited Partner to any and all benefits to which such Limited Partner may be entitled as provided in this Agreement and in the Act, together with the obligations of such Limited Partner to comply with all the provisions of this Agreement and of such Act.

"LIQUIDATING EVENT" has the meaning set forth in Section 2.4 hereof.

"LOSS" has the meaning provided in Section 5.1(f) hereof.

"LP CAPITAL" means the aggregate of Capital Contributions in cash or cash equivalents and the Agreed Value of any non-cash contributions to the Partnership made by a Limited Partner in accordance with Sections 4.1 and 4.2 hereof.

"LP RETURN" means, with regard to any Limited Partner, an amount equal to the aggregate cash dividends that would have been payable to such Limited Partner with respect to the applicable fiscal period if such Limited Partner had owned REIT Shares equal in number to the number of Partnership Units owned by such

Limited Partner during such fiscal period.

"MORTGAGE" means, in connection with mortgage financing provided, invested in or purchased by the Partnership, any note, deed of trust, security interest or other evidence of indebtedness or obligations, which is secured or collateralized by real property owned by the borrower under such note, deed of trust, security interest or other evidence of indebtedness or obligations.

"NET CAPITAL PROCEEDS" means the net cash proceeds received by the Partnership in connection with (i) any Sale, (ii) any borrowing or refinancing of borrowing(s) by the Partnership, (iii) any condemnation or deeding in lieu of condemnation of all or a portion of any Property, (iv) any collection in respect of property, hazard, or casualty insurance (but not business interruption insurance) or any damage award; or (v) any other transaction the proceeds of which, in accordance with generally accepted accounting principles, are considered to be capital in nature, in each case, after deduction of (a) all costs and expenses incurred by the Partnership with regard to such transactions (including, without limitation, any repayment of any indebtedness required to be repaid as a result of such transaction or which the General Partner elects to pay out of the proceeds of such transaction, together with accrued interest and premium, if any, thereon and any sales commissions or other costs or expenses due and payable to any Person in connection therewith, including to a Partner or its Affiliates), and (b) all amounts expended by the Partnership for the acquisition of additional Properties, Mortgages or other investments or for capital repairs or improvements to any Property with such cash proceeds.

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"OFFER" has the meaning set forth in Section 7.1(c)(ii) hereof.

"OFFERING" means the initial offer and sale by the General Partner and the purchase by the Underwriters (as defined in the Prospectus) of REIT Shares for sale to the public.

"ORIGINAL LIMITED PARTNER" means the Limited Partner designated as such on Exhibit A hereto.

"PARTNER" means any General Partner or Limited Partner.

"PARTNER NONRECOURSE DEBT MINIMUM GAIN" has the meaning set forth in Regulations Section 1.704-2(i). A Partner's share of Partner Nonrecourse Debt Minimum Gain shall be determined in accordance with Regulations Section 1.704-2(i)(5).

"PARTNERSHIP" means Gladstone Commercial Limited Partnership, a Delaware limited partnership.

"PARTNERSHIP INTEREST" means an ownership interest in the Partnership held by either a Limited Partner or the General Partner and includes any and all benefits to which the holder of such a Partnership Interest may be entitled as provided in this Agreement, together with all obligations of such Person to comply with the terms and provisions of this Agreement.

"PARTNERSHIP MINIMUM GAIN" has the meaning set forth in Regulations Section 1.704-2(b)(2). In accordance with Regulations Section 1.704-2(d), the amount of Partnership Minimum Gain is determined by first computing, for each Partnership nonrecourse liability, any gain the Partnership would realize if it disposed of the property subject to that liability for no consideration other than full satisfaction of the liability, and then aggregating the separately computed gains. A Partner's share of Partnership Minimum Gain shall be determined in accordance with Regulations Section 1.704-2(g)(1).

"PARTNERSHIP RECORD DATE" means the record date established by the General Partner for the distribution of cash pursuant to Section 5.2 hereof, which record date shall be the same as the record date established by the General Partner for a distribution to its stockholders of some or all of its portion of such distribution.

"PARTNERSHIP UNIT" means a fractional, undivided share of the Partnership Interests of all Partners issued hereunder. The allocation of Partnership Units among the Partners shall be as set forth on Exhibit A, as it may be amended from time to time. All Partnership Units issued to the General Partner or its Subsidiaries shall be Common Units or Preferred Units.

"PERCENTAGE INTEREST" means the percentage ownership interest in the Partnership of each Partner, as determined by dividing the number of Partnership Units owned by a Partner by the aggregate number of Partnership Units owned by all Partners. The Percentage Interest of each Partner shall be as set forth on Exhibit A, as it may be amended from time to time.

"PERSON" means any individual, partnership, corporation, joint venture, limited liability company, trust or other entity.

"PREFERRED UNITS" has the meaning provided in Section 4.2(a)(i)(1) hereof.

"PROFIT" has the meaning provided in Section 5.1(f) hereof.

"PROPERTY" means any industrial or commercial real property or any other investment in which the Partnership holds an ownership interest, either directly or pursuant to the Partnership's ownership of an interest in a subsidiary which owns an interest in any such industrial or commercial real property or other investment.

"PROSPECTUS" means the final prospectus delivered to purchasers of REIT Shares in the Offering.

"REGULATIONS" means the Federal Income Tax Regulations, including temporary or proposed regulations, issued under the Code, as amended and as hereafter amended from time to time. Reference to any particular provision of the Regulations shall mean that provision of the Regulations on the date hereof and any successor provision of the Regulations.

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"REIT" means a real estate investment trust under Sections 856 through 860 of the Code.

"REIT EXPENSES" means (i) costs and expenses relating to the formation and continuity of existence and operation of the General Partner and any Subsidiaries thereof (which Subsidiaries shall, for purposes hereof, be included within the definition of General Partner), including taxes, fees and assessments associated therewith, any and all costs, expenses or fees payable to any director, officer, or employee of the General Partner, (ii) costs and expenses relating to (A) any registration and public offering of securities by the General Partner, the net proceeds of which were used to make a contribution to the Partnership, and (B) all statements and reports incidental thereto, including, without limitation, underwriting discounts and selling commissions applicable to any such offering of securities, and any costs and expenses associated with any claims made by any holders of such securities or any underwriters or placement agents thereof, (iii) costs and expenses associated with any repurchase of any securities by the General Partner, (iv) costs and expenses associated with the preparation and filing, of any periodic or other reports and communications by the General Partner under federal, state or local laws or regulations, including filings with the Commission, (v) costs and expenses associated with compliance by the General Partner with laws, rules and regulations promulgated by any regulatory body, including the Commission and any securities exchange, (vi) costs and expenses associated with any section 401(k) plan, incentive plan, bonus plan or other plan providing for compensation for the employees of the General Partner, (vii) costs and expenses incurred by the General Partner relating to any issuance or redemption of Partnership Interests or REIT Shares, and (viii) all other operating or administrative costs of the General Partner incurred in the ordinary course of its business on behalf of or in connection with the Partnership.

"REIT PREFERRED SHARES" has the meaning provided in Section 4.2(a)(i)(1) hereof.

"REIT SHARE" means a share of common stock in the General Partner (or Successor Entity, as the case may be).

"REIT SHARES AMOUNT" means a number of REIT Shares equal to the product of the number of Partnership Units offered for exchange by an Exchanging Partner, multiplied by the Conversion Factor as adjusted to and including the Specified Exchange Date; provided that in the event the General Partner issues to all holders of REIT Shares rights, options, warrants or convertible or exchangeable securities entitling the stockholders to subscribe for or purchase REIT Shares, or any other securities or property (collectively, the "RIGHTS"), and the rights have not expired at the Specified Exchange Date, then the REIT Shares Amount shall also include the rights issuable to a holder of the REIT Shares on the record date fixed for purposes of determining the holders of REIT Shares entitled to such rights.

"SALE" means any transaction or series of transactions whereby (i) the Partnership directly or indirectly (except as described in other subsections of this definitions) sells, grants, transfers, conveys or relinquishes its ownership of any Property or portion thereof, including the lease of any Property consisting of a building only, and including any event with respect to any Property which gives rise to a significant amount of insurance proceeds or

condemnation awards; (ii) the Partnership directly or indirectly (except as described in other subsections of this definition) sells, grants, transfers, conveys or relinquishes its ownership of all or substantially all the interest of the Partnership in any Joint Venture in which it is a co-venturer or partner; (iii) any Joint Venture directly or indirectly (except as described in other subsections of this definition) in which the Partnership as a co-venturer or partner sells, grants, transfers, conveys or relinquishes its ownership of any Property or portion thereof, including any event with respect to any Property which gives rise to insurance claims or condemnation awards; (iv) the Partnership directly or indirectly (except as described in other subsections of this definition) sells, grants, conveys or relinquishes its interest in any Mortgage or portion thereof (including with respect to any Mortgage, all payments thereunder or in satisfaction thereof other than regularly scheduled interest payments) of amounts owed pursuant to such Mortgage and any event with respect to a Mortgage which gives rise to a significant amount of insurance proceeds or similar awards, or (v) the Partnership directly or indirectly (except as described in other subsections of this definition) sells, grants, transfers, conveys or relinquishes its ownership of any other asset (other than investments in bank accounts, money market funds or other current assets) not previously described in this definition or any portion thereof.

"SECURITIES ACT" means the Securities Act of 1933, as amended.

"SERVICE" means the Internal Revenue Service.

"SPECIFIED EXCHANGE DATE" means the first business day of the month first occurring after the expiration of 60 calendar days from the date of receipt by the General Partner of the Exchange Notice.

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"SUBSIDIARY" means, with respect to any Person, any corporation or other entity of which a majority of (i) the voting power of the voting equity securities or (ii) the outstanding equity interests is owned, directly or indirectly, by such Person.

"SUBSIDIARY PARTNERSHIP" means any partnership, limited liability company or other entity taxed as a partnership for federal income tax purposes in which interests are owned by the General Partner or by a wholly-owned Subsidiary or Subsidiaries of the General Partner.

"SUBSTITUTE LIMITED PARTNER" means any Person admitted to the Partnership as a Limited Partner pursuant to Section 9.3 hereof.

"SUCCESSOR ENTITY" has the meaning provided in the definition of "Conversion Factor" contained herein.

"SURVIVOR" has the meaning set forth in Section 7.1(d) hereof.

"TRANSACTION" has the meaning set forth in Section 7.1(c) hereof.

"TRANSFER" has the meaning set forth in Section 9.2(a) hereof.

"UNPAID RETURN" means any accrued but unpaid LP Return or GP Minimum Return less (i) all amounts distributed by the Partnership to a Limited Partner or the General Partner in reduction thereof, and (ii) all amounts distributed to the applicable Partner pursuant to clause (iv) of Section 5.2(a) hereof.

"VALUE" means, with respect to any security, the average of the daily market price of such security for the ten consecutive trading days immediately preceding the date as of which such Value is to be determined. The market price for each such trading day shall be: (i) if the security is listed or admitted to trading on any securities exchange, the sale price, regular way, on such day, or if no such sale takes place on such day, the average of the closing bid and asked prices, regular way, on such day; (ii) if the security is not listed or admitted to trading on any securities exchange, the last reported sale price on such day or, if no sale takes place on such day, the average of the closing bid and asked prices on such day, as reported by a reliable quotation source designated by the General Partner; or (iii) if the security is not listed or admitted to trading on any securities exchange and no such last reported sale price or closing bid and asked prices are available, the average of the reported high bid and low asked prices on such day, as reported by a reliable quotation source designated by the General Partner, or if there shall be no bid and asked prices on such day, the average of the high bid and low asked prices, as so reported, on the most recent day (not more than ten days prior to the date in question) for which prices have been so reported; provided, that if there are no bid and asked prices reported during the ten days prior to the date in question, the value of the security shall be determined by the General Partner acting in good faith on the basis of such quotations and other information as it considers, in its reasonable judgment, appropriate. In the event the security includes any additional rights, then the value of such rights shall be

determined by the General Partner acting in good faith on the basis of such quotations and other information as it considers, in its reasonable judgment, appropriate.

## ARTICLE 2

### PARTNERSHIP FORMATION AND IDENTIFICATION

2.1 FORMATION. The Partnership is a limited partnership formed pursuant to the Act and upon the terms and conditions set forth in this Agreement.

2.2 NAME, OFFICE AND REGISTERED AGENT. The name of the Partnership is "Gladstone Commercial Limited Partnership." The registered office and principal place of business of the Partnership shall be 1750 Tysons Boulevard, Fourth Floor, McLean, Virginia 22102. The General Partner may at any time change the location of such office, provided the General Partner gives notice to the Partners of any such change. The name and address of the Partnership's registered agent is The Corporation Trust Incorporated, 300 East Lombard Street,

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Baltimore, Maryland 21202. The sole duty of the registered agent as such is to forward to the Partnership any notice that is served on it as registered agent.

### 2.3 PARTNERS.

(a) The General Partner of the Partnership is Gladstone Commercial Corporation, a Maryland corporation. Its principal place of business is the same as that of the Partnership.

(b) The Limited Partners are those Persons identified as Limited Partners (including the Original Limited Partner) on Exhibit A hereto, as it may be amended from time to time.

### 2.4 TERM AND DISSOLUTION.

(a) The term of the Partnership shall continue in full force and effect until December 31, 2075, except that the Partnership shall be dissolved earlier upon the first to occur of any of the following events ("LIQUIDATING EVENTS"):

(i) the occurrence of an Event of Bankruptcy as to a General Partner or the dissolution, death, removal or withdrawal of a General Partner unless the business of the Partnership is continued pursuant to Section 7.3(b) hereof, provided, that if a General Partner is on the date of such occurrence a partnership, the dissolution of such General Partner as a result of the dissolution, death, withdrawal, removal or Event of Bankruptcy of a partner in such partnership shall not be an event of dissolution of the Partnership if the business of such General Partner is continued by the remaining partner or partners thereof, either alone or with additional partners, and such General Partner and such partners comply with any other applicable requirements of this Agreement;

(ii) the passage of 90 days after the sale or other disposition of all or substantially all of the assets of the Partnership (provided, that if the Partnership receives an installment obligation as consideration for such sale or other disposition, the Partnership shall continue, unless sooner dissolved under the provisions of this Agreement, until such time as such obligation is paid in full);

(iii) the exchange of all Limited Partnership Interests (other than any of such interests held by the General Partner or Affiliates of the General Partner) pursuant to Section 8.5 hereof; or

(iv) the election by the General Partner that the Partnership should be dissolved.

(b) Upon dissolution of the Partnership (unless the business of the Partnership is continued pursuant to Section 7.3(b) hereof), the General Partner (or its trustee, receiver, successor or legal representative) shall amend or cancel the Certificate and liquidate the Partnership's assets and apply and distribute the proceeds thereof in accordance with Section 5.6 hereof. Notwithstanding the foregoing, the liquidating General Partner may either (i) defer liquidation of, or withhold from distribution for a reasonable time, any assets of the Partnership (including those necessary to satisfy the Partnership's debts and obligations), or (ii) distribute the assets to the Partners in kind.

2.5 FILING OF CERTIFICATE AND PERFECTION OF LIMITED PARTNERSHIP. The General Partner shall execute, acknowledge, record and file, at the expense of

the Partnership, the Certificate and any and all amendments thereto and all requisite fictitious name statements and notices in such places and jurisdictions as may be necessary to cause the Partnership to be treated as a limited partnership under, and otherwise to comply with, the laws of each state or other jurisdiction in which the Partnership conducts business.

2.6 CERTIFICATES DESCRIBING PARTNERSHIP UNITS. At the request of a Limited Partner, the General Partner may, at its option and in its discretion, issue a certificate summarizing the terms of such Limited Partner's interest in the Partnership, including the number of Partnership Units owned as of the date of such certificate. If issued, any such certificates (a) shall be in form and substance as approved by the General Partner, (b) shall not be negotiable, and (c) shall bear a legend substantially similar to the following:

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"THIS CERTIFICATE IS NOT NEGOTIABLE. THE PARTNERSHIP UNITS REPRESENTED BY THIS CERTIFICATE ARE GOVERNED BY AND TRANSFERABLE ONLY IN ACCORDANCE WITH THE PROVISIONS OF THE AGREEMENT OF LIMITED PARTNERSHIP OF GLADSTONE COMMERCIAL LIMITED PARTNERSHIP, AS AMENDED FROM TIME TO TIME."

### ARTICLE 3

#### BUSINESS OF THE PARTNERSHIP

The purpose and nature of the business to be conducted by the Partnership is (a) to conduct any business that may be lawfully conducted by a limited partnership organized pursuant to the Act, provided, however, that such business shall be limited to and conducted in such a manner as to permit the General Partner at all times to qualify as a REIT, unless the General Partner otherwise ceases to qualify as a REIT, (b) to enter into any partnership, joint venture or other similar arrangement to engage in any of the foregoing or the ownership of interests in any entity engaged in any of the foregoing, and (c) to do anything necessary or incidental to the foregoing. In connection with the foregoing, and without limiting the General Partner's right in its sole and absolute discretion to cease qualifying as a REIT, the Partners acknowledge that the General Partner's current status as a REIT and the avoidance of income and excise taxes on the General Partner inures to the benefit of all the Partners and not solely to the General Partner. Notwithstanding the foregoing, the Limited Partners agree that the General Partner may terminate its status as a REIT under the Code at any time to the full extent permitted under its Articles of Incorporation. The General Partner shall also be empowered to do any and all acts and things necessary or prudent to ensure that the Partnership will not be classified as a "publicly traded partnership" for purposes of Section 7704 of the Code.

### ARTICLE 4

#### CAPITAL CONTRIBUTIONS AND ACCOUNTS

4.1 CAPITAL CONTRIBUTIONS. The General Partner and the Original Limited Partner have made Capital Contributions to the Partnership in exchange for the Partnership Units set forth opposite their names on Exhibit A, all of which are Common Units. At such time as Additional Limited Partners are admitted to the Partnership, each shall make Capital Contributions as set forth opposite their names on Exhibit A, as it may be amended from time to time.

4.2 ADDITIONAL CAPITAL CONTRIBUTIONS AND ISSUANCES OF ADDITIONAL PARTNERSHIP INTERESTS. Except as provided in this Section 4.2 or in Section 4.3, the Partners shall have no right or obligation to make any additional Capital Contributions or loans to the Partnership. The General Partner may contribute additional capital to the Partnership, from time to time, and receive additional Partnership Units in respect thereof in the manner contemplated by this Section 4.2.

(a) Issuances of Additional Partnership Interests.

(i) General. The General Partner is hereby authorized to cause the Partnership to issue additional Partnership Interests in the form of Partnership Units for any Partnership purpose, at any time or from time to time, to the Partners (including the General Partner) or to other Persons for such consideration and on such terms and conditions as shall be established by the General Partner in its sole and absolute discretion, all without the approval of any Limited Partners. Any additional Partnership Interests issued thereby may be issued in one or more classes, or one or more series of any of such classes, with such designations, preferences and relative participating, optional or other special rights, powers and duties, including rights, powers and duties senior to Limited Partnership Interests, all as shall be determined



by the General Partner in its sole and absolute discretion and without the approval of any Limited Partner, subject to Delaware law, including, without limitation, (A) the allocations of items of Partnership income, gain, loss, deduction and credit to each such class or series of Partnership Interests; (B) the right of each such class or series of Partnership Interests to share in Partnership distributions; and (C) the rights of each such class or series of Partnership Interests upon dissolution and liquidation of the Partnership; provided, however, that no additional Partnership Interests shall be issued to the General Partner or the Original Limited Partner unless:

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(1) the additional Partnership Interests are issued in connection with an issuance of REIT Shares of, or other shares of or interests in, the General Partner which shares or interests ("REIT Preferred Shares") have designations, preferences and other rights such that the economic interests are substantially similar to the designations, preferences and other rights of the additional Partnership Interests issued to the General Partner by the Partnership in accordance with this Section 4.2 ("Preferred Units"), and the General Partner, on its own or with the Original Limited Partner, shall make a Capital Contribution to the Partnership in an amount equal to the aggregate proceeds raised in connection with the issuance of such REIT Shares or REIT Preferred Shares, as the case may be, of the General Partner;

(2) the additional Partnership Interests are issued in exchange for property or other assets owned by the General Partner or Original Limited Partner with a fair market value, as determined by the General Partner, in good faith, equal to the value of the Partnership Interests; or

(3) the additional Partnership Interests are issued to all Partners in proportion to their respective Percentage Interests.

Without limiting the foregoing, the General Partner is expressly authorized to cause the Partnership to issue Partnership Units for less than fair market value, so long as the General Partner concludes in good faith that such issuance is in the best interests of the General Partner and the Partnership.

(ii) Issuance of Additional Securities. The General Partner shall not issue any additional REIT Shares (other than REIT Shares issued in connection with an exchange made pursuant to Section 8.5 hereof) or rights, options, warrants or convertible or exchangeable securities containing the right to subscribe for or purchase REIT Shares (collectively, "Additional Securities") other than to all holders of REIT Shares, unless (A) the General Partner shall cause the Partnership to issue to the General Partner (or to the General Partner and the Original Limited Partner), as the General Partner may designate, Partnership Interests or rights, options, warrants or convertible or exchangeable securities of the Partnership having designations, preferences and other rights such that the economic interests are substantially similar to those of the Additional Securities, and (B) the General Partner (or the General Partner and the Original Limited Partner) contributes the proceeds from the issuance of such Additional Securities and from any exercise of rights contained in such Additional Securities, directly and through the General Partner (or the General Partner and the Original Limited Partner), to the Partnership; provided, however, that the General Partner is allowed to issue Additional Securities in connection with an acquisition of a Property or other asset to be held directly by the General Partner, but if and only if, such direct acquisition and issuance of Additional Securities have been approved and determined to be in the best interests of the General Partner and the Partnership by a majority of the Independent Directors. Without limiting the foregoing, the General Partner is expressly authorized to issue Additional Securities for less than fair market value, and to cause the Partnership to issue to the General Partner (or to the General Partner and the Original Limited Partner) corresponding Partnership Interests, so long as (1) the General Partner concludes in good faith that such issuance is in the best interests of the General Partner and the Partnership, including without limitation, the issuance of REIT Shares and corresponding Partnership Units pursuant to an employee share purchase plan providing for employee purchases of REIT Shares at a discount from fair market value or employee stock options that have an exercise price that is less than the fair market value of the REIT Shares, either at the time of issuance or at the time of exercise, and (2) the General Partner contributes directly or directly and through the Original Limited Partner all proceeds from such issuance to the Partnership. For example, in the event the General Partner issues REIT Shares for a cash purchase price and contributes all of the proceeds of such issuance to the Partnership as required hereunder, the General Partner shall be issued a number of additional Partnership Units equal to the product of (A) the number of such REIT Shares issued by the General Partner, the proceeds of which were so contributed, multiplied by (B) a fraction, the numerator of which is 100%, and the denominator of which is the Conversion Factor in effect on the date of such contribution.

(b) Certain Deemed Contributions of Proceeds of Issuance of REIT Shares. In connection with any and all issuances of REIT Shares, the General Partner shall make directly or directly and through the Original Limited Partner Capital Contributions to the Partnership of the proceeds therefrom, provided, that if the proceeds actually received and contributed by the General Partner are less than the gross proceeds of such issuance as a result of any underwriter's discount or other fees or expenses paid or incurred in connection with such issuance, then the General Partner (or the General Partner together with the Original Limited Partner, as applicable) shall be deemed to have made Capital Contributions to the Partnership in the aggregate amount of the gross proceeds of such

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issuance and the Partnership shall be deemed simultaneously to have paid such offering expenses in accordance with Section 6.5 hereof and in connection with the required issuance of additional Partnership Units for such Capital Contributions pursuant to Section 4.2(a) hereof. Upon any such Capital Contribution by the General Partner, the General Partner's Capital Account shall be increased by the actual amount of its Capital Contribution pursuant to Section 4.4 hereof.

(c) Repurchases of General Partner Shares. If the General Partner shall repurchase shares of any class of the General Partner's capital stock, all costs incurred in connection with such repurchase shall be reimbursed to the General Partner by the Partnership pursuant to Section 6.5 hereof and the General Partner shall cause the Partnership to redeem an equivalent number of Partnership Interests of the appropriate class held by the General Partner (which, in the case of REIT Shares, shall be a number equal to the quotient of the number of such REIT Shares divided by the Conversion Factor) in the manner provided in Section 6.10.

4.3 ADDITIONAL FUNDING. If the General Partner determines that it is in the best interests of the Partnership to provide for additional Partnership funds ("ADDITIONAL FUNDS") for any Partnership purpose, the General Partner may (a) cause the Partnership to obtain such funds from outside borrowings, or (b) elect to have the General Partner or any of its Affiliates provide such Additional Funds to the Partnership through loans or otherwise.

4.4 CAPITAL ACCOUNTS. A separate capital account (a "CAPITAL ACCOUNT") shall be established and maintained for each Partner in accordance with Regulations Section 1.704-1(b)(2)(iv). If (a) a new or existing Partner acquires an additional Partnership Interest in exchange for more than a de minimis Capital Contribution, (b) the Partnership distributes to a Partner more than a de minimis amount of Partnership property as consideration for the redemption of a Partnership Interest, or (c) the Partnership is liquidated within the meaning of Regulations Section 1.704-1(b)(2)(ii)(g), the General Partner shall revalue the property of the Partnership to its fair market value (as determined by the General Partner, in its sole and absolute discretion, and taking into account Section 7701(g) of the Code) in accordance with Regulations Section 1.704-1(b)(2)(iv)(f). When the Partnership's property is revalued by the General Partner, the Capital Accounts of the Partners shall be adjusted in accordance with Regulations Sections 1.704-1(b)(2)(iv)(f) and (g), which generally require such Capital Accounts to 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 pursuant to Section 5.1 hereof if there were a taxable disposition of such property for its fair market value (as determined by the General Partner, in its sole and absolute discretion, and taking into account Section 7701(g) of the Code) on the date of the revaluation.

4.5 PERCENTAGE INTERESTS. If the number of outstanding Partnership Units increases or decreases during a taxable year, each Partner's Percentage Interest shall be adjusted by the General Partner effective as of the date of each such increase or decrease to a percentage equal to the number of Partnership Units held by such Partner divided by the aggregate number of Partnership Units outstanding after giving effect to such increase or decrease. In such event, the General Partner shall revalue the property of the Partnership and the Capital Account for each Partner shall be adjusted as set forth in Section 4.4 hereof. If the Partners' Percentage Interests are adjusted pursuant to this Section 4.5, the Profit and Loss for the taxable year in which the adjustment occurs shall be prorated between the part of the year ending on the day when the Partnership's property is revalued by the General Partner and the part of the year beginning on the following day and, as so divided, shall be allocated to the Partners based on their Percentage Interests before adjustment, and their adjusted Percentage Interests, respectively, either (a) as if the taxable year had ended on the date of the adjustment or (b) based on the number of days in each part. The General Partner, in its sole and absolute discretion,

shall determine which method shall be used to allocate Profit and Loss for the taxable year in which an adjustment occurs, as may be required or permitted under Section 706 of the Code.

4.6 NO INTEREST ON CONTRIBUTIONS. No Partner shall be entitled to interest on its Capital Contribution.

4.7 RETURN OF CAPITAL CONTRIBUTIONS. No Partner shall be entitled to withdraw any part of its Capital Contribution or its Capital Account or to receive any distribution from the Partnership, except as specifically provided in this Agreement. Except as otherwise provided herein, there shall be no obligation to return to any Partner or withdrawn Partner any part of such Partner's Capital Contribution for so long as the Partnership continues in existence.

4.8 NO THIRD PARTY BENEFICIARY. No creditor or other third party having dealings with the Partnership shall have the right to enforce the right or obligation of any Partner to make Capital Contributions or loans or to pursue any other right or remedy hereunder or at law or in equity, it being understood and agreed that the provisions of this Agreement shall be solely for the benefit of, and may be enforced solely by, the parties hereto and their respective successors and assigns. None of the rights or obligations of the Partners herein set forth to make Capital Contributions or loans to the Partnership shall be deemed an asset of the Partnership for any purpose by any creditor or other third party, nor may such rights or obligations be sold, transferred or assigned by the Partnership or

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pledged or encumbered by the Partnership to secure any debt or other obligation of the Partnership or of any of the Partners. In addition, it is the intent of the parties hereto that no distribution to any Limited Partner shall be deemed a return of money or other property in violation of the Act. However, if any court of competent jurisdiction holds that, notwithstanding the provisions of this Agreement, any Limited Partner is obligated to return such money or property, such obligation shall be the obligation of such Limited Partner and not of the General Partner. Without limiting the generality of the foregoing, a deficit Capital Account of a Partner shall not be deemed to be a liability of such Partner nor an asset or property of the Partnership.

## ARTICLE 5

### PROFIT AND LOSS; DISTRIBUTIONS

#### 5.1 ALLOCATION OF PROFIT AND LOSS.

(a) Profit and Loss. After giving effect to the special allocations set forth in Sections 5.1(b), (c) and (d), Profit for each fiscal year of the Partnership shall be allocated as follows: (i) first, to the General Partner until the cumulative Profit allocated to the General Partner under this clause (i) equals the cumulative Loss allocated to the General Partner under clause (z) of this Section 5.1(a), (ii) second, to the Partners, pro rata, in accordance with and in proportion to their respective Partnership Interests, in amounts equal to the amount of cash distributed to the Partners pursuant to Section 5.2(a) hereof with respect to such fiscal year; (iii) third, to the extent the amount of Profit for such fiscal year exceeds the amount of cash distributed to the Partners pursuant to Section 5.2(a) hereof, such excess shall be allocated to the General Partner and the Limited Partners in amounts and in proportion to the cumulative Loss allocated to the General Partner pursuant to clause (y) of this Section 5.1(a) and the cumulative Loss allocated to the Limited Partners pursuant to clause (x) of this Section 5.1(a), respectively; and (iv) finally, the balance, if any, of Profit shall be allocated to the Partners in accordance with and in proportion to their respective Percentage Interests. Notwithstanding the foregoing, however, it is the intent of the Partners that allocations of Profit to the Limited Partners be such that the amount of Profit allocated to each Limited Partner be equal to the amount of income that would have been allocated to such Limited Partner with respect to the applicable fiscal period if such Limited Partner had owned REIT Shares equal in number to the number of Partnership Units owned by such Limited Partner during such fiscal period, and if, for any reason in any fiscal period, the foregoing allocations of Profit result in any material variation from this concept, Profit for such fiscal period shall instead be allocated to each Limited Partner in an amount equal to the aggregate amount of income that would have been allocated to such Limited Partner with respect to such fiscal period if such Limited Partner had owned REIT Shares equal in number to the number of Partnership Units owned by such Limited Partner during such fiscal period. After giving effect to the special allocations set forth in Sections 5.1(b), (c) and (d), Loss for a fiscal year of the Partnership shall be allocated as follows: (w) first, to the Partners, pro rata, in accordance with and in proportion to

their respective Partnership Interests, until the cumulative Loss allocated to each Partner under this clause (w) equals the cumulative Profit allocated to each Partner under clause (iv) of this Section 5.1(a); (x) second, to the Limited Partners in an amount equal to each such Limited Partner's Capital Account balance prior to the allocation made under this clause (x); (y) third, to the General Partner in an amount equal to the General Partner's Capital Account balance prior to the allocation made under this clause (y); and (z) fourth, to the General Partner to the extent that any further allocation of Loss to Limited Partners would result in any such Limited Partners having a deficit balance in their Capital Accounts.

(b) Minimum Gain Chargeback. Notwithstanding any provision to the contrary herein, (i) any expense of the Partnership that is a "nonrecourse deduction" within the meaning of Regulations Section 1.704-2(b)(1) shall be allocated in accordance with the Partners' respective Percentage Interests, (ii) any expense of the Partnership that is a "partner nonrecourse deduction" within the meaning of Regulations Section 1.704-2(i)(2) shall be allocated to the Partner that bears the "economic risk of loss" of such deduction in accordance with Regulations Section 1.704-2(i)(1), (iii) if there is a net decrease in Partnership Minimum Gain within the meaning of Regulations Section 1.704-2(f)(1) for any Partnership taxable year, then, subject to the exceptions set forth in Regulations Section 1.704-2(f)(2), (3), (4) and (5), items of gain and income shall be allocated among the Partners in accordance with Regulations Section 1.704-2(f) and the ordering rules contained in Regulations Section 1.704-2(j), and (iv) if there is a net decrease in Partner nonrecourse debt minimum gain within the meaning of Regulations

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Section 1.704-2(i)(4) for any Partnership taxable year, then, subject to the exceptions set forth in Regulations Section 1.704-2(g), items of gain and income shall be allocated among the Partners, in accordance with Regulations Section 1.704-2(i)(4) and the ordering rules contained in Regulations Section 1.704-2(j). A Partner's "interest in partnership profits" for purposes of determining its share of the nonrecourse liabilities of the Partnership within the meaning of Regulations Section 1.752-3(a)(3) shall be such Partner's Percentage Interest.

(c) Qualified Income Offset. If a Partner receives in any taxable year an adjustment, allocation, or distribution described in subparagraphs (4), (5), or (6) of Regulations Section 1.704-1(b)(2)(ii)(d) that causes or increases a deficit balance in such Partner's Capital Account that exceeds the sum of such Partner's shares of Partnership Minimum Gain and Partner nonrecourse debt minimum gain, as determined in accordance with Regulations Sections 1.704-2(g) and 1.704-2(i), such Partner shall be allocated specially for such taxable year (and, if necessary, later taxable years) items of income and gain in an amount and manner sufficient to eliminate such deficit Capital Account balance as quickly as possible as provided in Regulations Section 1.704-1(b)(2)(ii)(d). After the occurrence of an allocation of income or gain to a Partner in accordance with this Section 5.1(c), to the extent permitted by Regulations Section 1.704-1(b), items of expense or loss shall be allocated to such Partner in an amount necessary to offset the income or gain previously allocated to such Partner under this Section 5.1(c).

(d) Capital Account Deficits. Loss shall not be allocated to a Limited Partner to the extent that such allocation would cause a deficit in such Partner's Capital Account (after reduction to reflect the items described in Regulations Section 1.704-1(b)(2)(ii)(d)(4), (5) and (6)) to exceed the sum of such Partner's shares of Partnership Minimum Gain and Partner nonrecourse debt minimum gain. Any Loss in excess of that limitation shall be allocated to the General Partner. After the occurrence of an allocation of Loss to the General Partner in accordance with this Section 5.1(d), to the extent permitted by Regulations Section 1.704-1(b), Profit shall be allocated to the General Partner in an amount necessary to offset the Loss previously allocated to the General Partner under this Section 5.1(d).

(e) Allocations Between Transferor and Transferee. If a Partner transfers any part or all of its Partnership Interest, the distributive shares of the various items of Profit and Loss allocable among the Partners during such fiscal year of the Partnership shall be allocated between the transferor and the transferee Partner either (i) as if the Partnership's fiscal year had ended on the date of the transfer, or (ii) based on the number of days of such fiscal year that each was a Partner without regard to the results of Partnership activities in the respective portions of such fiscal year in which the transferor and the transferee were Partners. The General Partner, in its sole and absolute discretion, shall determine which method shall be used to allocate the distributive shares of the various items of Profit and Loss between the transferor and the transferee Partner.

(f) Definitions of Profit and Loss. "PROFIT" and "LOSS" and any items of income, gain, expense, or loss referred to in this Agreement shall

be determined in accordance with federal income tax accounting principles, as modified by Regulations Section 1.704-1(b)(2)(iv), except that Profit and Loss shall not include items of income, gain and expense that are specially allocated pursuant to Sections 5.1(b), 5.1(c), or 5.1(d). All allocations of income, Profit, gain, Loss, and expense (and all items contained therein) for federal income tax purposes shall be identical to all allocations of such items set forth in this Section 5.1, except as otherwise required by Section 704(c) of the Code and Regulations Section 1.704-1(b)(4). The General Partner shall have the authority, in its sole and absolute discretion and without the need for consent from any Partner, to elect the method or methods to be used by the Partnership for allocating items of income, gain, expense and deductions as required by Section 704(c) of the Code, including election of a method that may result in one or more Partners receiving or being allocated a disproportionately larger share of items of Partnership income, gain, expense or deduction, and any such election shall be binding on all Partners.

## 5.2 DISTRIBUTIONS OF CASH.

(a) Subject to paragraph (b), the Partnership shall distribute cash on a quarterly (or, at the election of the General Partner, more frequent) basis, in an amount determined by the General Partner in its sole and absolute discretion, to the Partners who are Partners on the Partnership Record Date with respect to such quarter (or other distribution period) in the following manner: (i) first, to the General Partner in an amount equal to the GP Minimum Return with respect to the fiscal year of the General Partner; (ii) second, to the Limited Partners pro rata among them in proportion to their respective Unpaid Return, if any, owing to each such Limited Partners with

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respect to prior fiscal years, in an amount equal to their respective Unpaid Return for such prior fiscal years owing to each such Limited Partner; (iii) third, after the establishment of reasonable cash reserves to meet REIT Expenses and other obligations of the Partnership, as determined in the sole and absolute discretion of the General Partner, to the General Partner and the Limited Partners in such aggregate amount as may be determined by the General Partner in its sole and absolute discretion to be allocated among the General Partner and the Limited Partners such that each Limited Partner will receive an amount equal to its LP Return for such fiscal year; and (iv) finally, to the Partners in accordance with and in proportion to their respective Percentage Interests; provided, however, that if a new or existing Partner acquires an additional Partnership Interest in exchange for a Capital Contribution on any date other than a Partnership Record Date, the cash distribution attributable to such additional Partnership Interest relating to the Partnership Record Date next following the issuance of such additional Partnership Interest shall be reduced to the proportion thereof which equals (i) the number of days that such additional Partnership Interest is held by such Partner divided by (ii) the number of days between such Partnership Record Date and the immediately preceding Partnership Record Date.

(b) Notwithstanding any other provision of this Agreement, the General Partner is authorized to take any action that it determines to be necessary or appropriate to cause the Partnership to comply with any withholding requirements established under the Code or any other federal, state or local law including, without limitation, the requirements of Sections 1441, 1442, 1445 and 1446 of the Code. To the extent that the Partnership is required to withhold and pay over to any taxing authority any amount resulting from the allocation or distribution of income to a Partner or its assignee (including by reason of Section 1446 of the Code), either (i) if the actual amount to be distributed to the Partner or assignee equals or exceeds the amount required to be withheld by the Partnership, the amount withheld shall be treated as a distribution of cash in the amount of such withholding to such Partner or assignee, or (ii) if the actual amount to be distributed to the Partner or assignee is less than the amount required to be withheld by the Partnership, the amount required to be withheld shall be treated as a loan (a "PARTNERSHIP LOAN") from the Partnership to the Partner or assignee on the day the Partnership pays over such amount to a taxing authority. A Partnership Loan shall be repaid through withholding by the Partnership with respect to subsequent distributions to the applicable Partner or assignee. In the event that a Limited Partner (a "DEFAULTING LIMITED PARTNER") fails to pay any amount owed to the Partnership with respect to the Partnership Loan within 15 days after demand for payment thereof is made by the Partnership on the Limited Partner, the General Partner, in its sole and absolute discretion, may elect to make the payment to the Partnership on behalf of such Defaulting Limited Partner. In such event, on the date of payment, the General Partner shall be deemed to have extended a loan (a "GENERAL PARTNER LOAN") to the Defaulting Limited Partner in the amount of the payment made by the General Partner and shall succeed to all rights and remedies of the Partnership against the Defaulting Limited Partner as to that amount. Without limitation, the General Partner shall have the right to receive any distributions that otherwise would be made by the Partnership to the Defaulting Limited Partner until such time as the General Partner Loan has been paid in

full, and any such distributions so received by the General Partner shall be treated as having been received by the Defaulting Limited Partner and immediately paid to the General Partner. Any amounts treated as a Partnership Loan or a General Partner Loan pursuant to this Section 5.2(b) shall bear interest at the lesser of (A) the base rate on corporate loans at large United States money center commercial banks, as published from time to time in The Wall Street Journal, or (B) the maximum lawful rate of interest on such obligation, such interest to accrue from the date the Partnership or the General Partner, as applicable, is deemed to extend the loan until such loan is repaid in full.

(c) To the extent not utilized for expenses of the Partnership or for investment in additional Properties, the General Partner may, in its discretion, cause the Partnership to distribute Net Capital Proceeds in such amount as shall be determined by the General Partner in its discretion in accordance with the provisions of Section 5.2(a) hereof.

(d) In no event may a Partner receive a distribution of cash with respect to a Partnership Unit if such Partner is entitled to receive a cash dividend as the holder of record of a REIT Share for which all or part of such Partnership Unit has been or will be exchanged, and the Unpaid Return with respect to such Partnership Unit shall be deemed to be reduced by the amount of any such cash dividend.

5.3 REIT DISTRIBUTION REQUIREMENTS. The General Partner shall use its reasonable efforts to cause the Partnership to distribute amounts sufficient to enable the General Partner to pay stockholder dividends that will allow the General Partner to (a) meet its distribution requirement for qualification as a REIT as set forth in

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Section 857 of the Code and (b) avoid any federal income or excise tax liability imposed by the Code, other than to the extent the General Partner elects to retain and pay income tax on its net capital gain.

5.4 NO RIGHT TO DISTRIBUTIONS IN KIND. No Partner shall be entitled to demand property other than cash in connection with any distributions by the Partnership.

5.5 LIMITATIONS ON RETURN OF CAPITAL CONTRIBUTIONS. Notwithstanding any of the provisions of this Article 5, no Partner shall have the right to receive and the General Partner shall not have the right to make a distribution that includes a return of all or part of a Partner's Capital Contributions, unless after giving effect to the return of a Capital Contribution, the sum of all Partnership liabilities, other than the liabilities to a Partner for the return of its Capital Contribution, does not exceed the fair market value of the Partnership's assets.

5.6 DISTRIBUTIONS UPON LIQUIDATION. Upon liquidation of the Partnership, after payment of, or adequate provision for, debts and obligations of the Partnership, including any Partner loans, any remaining assets of the Partnership shall be distributed to all Partners with positive Capital Accounts in accordance with their respective positive Capital Account balances. For purposes of the preceding sentence, the Capital Account of each Partner shall be determined after the following adjustments: (i) all adjustments made in accordance with Sections 5.1 and 5.2 resulting from Partnership operations and from all sales and dispositions of all or any part of the Partnership's assets (including adjustments reflecting any deemed Profit or Loss attributable to assets distributed in kind), and (ii) allocating any available Profit first to the General Partner in an amount equal to the excess of (A) the value of the Partnership Units it received in exchange for Capital Contributions of the proceeds of an issuance of REIT Shares pursuant to Section 4.2(b) hereof over (B) the actual amount of its Capital Contributions pursuant to Section 4.2(b) hereof (i.e., as a result of any underwriters' discount or other expenses paid or incurred in connection with such issuance). Any distributions pursuant to this Section 5.6 shall be made by the end of the Partnership's taxable year in which the liquidation occurs (or, if later, within 90 days after the date of the liquidation). To the extent deemed advisable by the General Partner, appropriate arrangements (including the use of a liquidating trust) may be made to assure that adequate funds are available to pay any contingent debts or obligations.

5.7 SUBSTANTIAL ECONOMIC EFFECT. It is the intent of the Partners that the allocations of Profit and Loss under this Agreement have substantial economic effect (or be consistent with the Partners' interests in the Partnership in the case of the allocation of losses attributable to nonrecourse debt) within the meaning of Section 704(b) of the Code as interpreted by the Regulations promulgated pursuant thereto. Article 5 and other relevant provisions of this Agreement shall be interpreted in a manner consistent with such intent.

ARTICLE 6

RIGHTS, OBLIGATIONS AND  
POWERS OF THE GENERAL PARTNER

6.1 MANAGEMENT OF THE PARTNERSHIP.

(a) Except as otherwise expressly provided in this Agreement, the General Partner shall have full, complete and exclusive discretion to manage and control the business of the Partnership for the purposes herein stated, and shall make all decisions affecting the business and assets of the Partnership. Subject to the restrictions specifically contained in this Agreement, the powers and obligations, as the context requires, of the General Partner shall include, without limitation, the authority to take the following actions on behalf of the Partnership:

(i) to acquire, purchase, own, operate, lease and dispose of any real property and any other property or assets including, but not limited to notes, Mortgages, partnership or joint venture interests or securities, that the General Partner determines are necessary or appropriate or in the best interests of the business of the Partnership;

(ii) to construct buildings and make other improvements on the Properties owned or leased by the Partnership;

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(iii) to authorize, issue, sell, redeem or otherwise purchase any Partnership Interests or any securities (including secured and unsecured debt obligations of the Partnership, debt obligations of the Partnership convertible into any class or series of Partnership Interests, or options, rights, warrants or appreciation rights relating to any Partnership Interests) of the Partnership;

(iv) to borrow or lend money for the Partnership, issue or receive evidences of indebtedness in connection therewith, refinance, increase the amount of, modify, amend or change the terms of, or extend the time for the payment of, any such indebtedness, and secure such indebtedness by mortgage, deed of trust, pledge or other lien on the Partnership's assets;

(v) to pay, either directly or by reimbursement, for all operating costs and general administrative expenses of the Partnership to third parties or to the General Partner or its Affiliates as set forth in this Agreement;

(vi) to guarantee or become a co-maker of indebtedness of the General Partner or any Subsidiary thereof, refinance, increase the amount of, modify, amend or change the terms of, or extend the time for the payment of, any such guarantee or indebtedness, and secure such guarantee or indebtedness by mortgage, deed of trust, pledge or other lien on the Partnership's assets;

(vii) to use assets of the Partnership (including, without limitation, cash on hand) for any purpose consistent with this Agreement, including, without limitation, payment, either directly or by reimbursement, of all operating costs and general administrative expenses of the General Partner, the Partnership or any Subsidiary of either, to third parties or to the General Partner as set forth in this Agreement;

(viii) to lease all or any portion of any of the Partnership's assets, whether or not the terms of such leases extend beyond the termination date of the Partnership and whether or not any portion of the Partnership's assets so leased are to be occupied by the lessee, or, in turn, subleased in whole or in part to others, for such consideration and on such terms as the General Partner may determine;

(ix) to prosecute, defend, arbitrate, or compromise any and all claims or liabilities in favor of or against the Partnership, on such terms and in such manner as the General Partner may reasonably determine, and similarly, to prosecute, settle or defend litigation with respect to the Partners, the Partnership, or the Partnership's assets;

(x) to file applications, communicate, and otherwise deal with any and all governmental agencies having jurisdiction over, or in any way affecting, the Partnership's assets or any other aspect of the Partnership business;

(xi) to make or revoke any election permitted or required of the Partnership by any taxing authority;

(xii) to maintain such insurance coverage for public

liability, fire and casualty, and any and all other insurance for the protection of the Partnership, for the conservation of Partnership assets, or for any other purpose convenient or beneficial to the Partnership, in such amounts and such types, as it shall determine from time to time;

(xiii) to determine whether or not to apply any insurance proceeds for any Property to the restoration of such Property or to distribute the same;

(xiv) to establish one or more divisions of the Partnership, to hire and dismiss employees of the Partnership or any division of the Partnership, and to retain legal counsel, accountants, consultants, real estate brokers, and such other persons, as the General Partner may deem necessary or appropriate in connection with the Partnership business and to pay such persons remuneration as the General Partner may deem reasonable and proper;

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(xv) to retain other services of any kind or nature in connection with Partnership business and to pay such remuneration as the General Partner may deem reasonable and proper for same;

(xvi) to negotiate and conclude agreements on behalf of the Partnership with respect to any of the rights, powers and authority conferred upon the General Partner;

(xvii) to maintain accurate accounting records and to file promptly all federal, state and local income tax returns on behalf of the Partnership;

(xviii) to distribute Partnership cash or other Partnership assets in accordance with this Agreement;

(xix) to form or acquire an interest in, and contribute property to, any further limited or general partnerships, joint ventures, limited liability companies or other entities or relationships that it deems desirable (including, without limitation, the acquisition of interests in, and the contributions of property to, its Subsidiaries and any other Person in which it has an equity interest from time to time);

(xx) to establish Partnership reserves for working capital, capital expenditures, contingent liabilities, or any other valid Partnership purpose;

(xxi) to merge, consolidate or combine the Partnership with or into another Person;

(xxii) to do any and all acts and things necessary or prudent to ensure that the Partnership will not be classified as a "publicly traded partnership" for purposes of Section 7704 of the Code; and

(xxiii) to take such other action, execute, acknowledge, swear to or deliver such other documents and instruments, and perform any and all other acts that the General Partner deems necessary or appropriate for the formation, continuation and conduct of the business and affairs of the Partnership (including, without limitation, all actions consistent with allowing the General Partner at all times to qualify as a REIT unless the General Partner voluntarily terminates its REIT status) and to possess and enjoy all of the rights and powers of a general partner as provided by the Act.

(b) Except as otherwise provided herein, to the extent the duties of the General Partner require expenditures of funds to be paid to third parties, the General Partner shall not have any obligations hereunder except to apply Partnership funds to the extent that Partnership funds are reasonably available to it for the performance of such duties, and nothing herein contained shall be deemed to authorize or require the General Partner, in its capacity as such, to expend its individual funds for payment to third parties or to undertake any individual liability or obligation on behalf of the Partnership.

6.2 DELEGATION OF AUTHORITY. The General Partner may delegate any or all of its powers, rights and obligations hereunder, and may appoint, employ, contract or otherwise deal with any Person (including without limitation the Adviser, its officers and agents and officers or other agents of the Partnership or the General Partner appointed by the General Partner) for the transaction of the business of the Partnership, which Person may, under supervision of the General Partner, perform any acts or services for the Partnership as the General Partner may approve.

6.3 INDEMNIFICATION AND EXCULPATION OF INDEMNITEES.



(a) The Partnership shall indemnify an Indemnitee from and against any and all losses, claims, damages, liabilities, joint or several, expenses (including reasonable legal fees and expenses), judgments, fines, settlements, and other amounts arising from any and all claims, demands, actions, suits or proceedings, civil, criminal, administrative or investigative, that relate to the operations of the Partnership as set forth in this Agreement in which any Indemnitee may be involved, or is threatened to be involved, as a party or otherwise, as a result of acting on behalf of or performing services for the Partnership, only if it is determined that (i) the Indemnitee acted in good faith and (ii) that the Indemnitee reasonably believed that the act or omission was in the Partnership's best interests, or if the act or omission was outside the Indemnitee's official capacity as a general partner of the Partnership, that the act or omission was at least not opposed to the Partnership's best

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interests. Notwithstanding the foregoing, each Indemnitee shall be liable, responsible and accountable, and the Partnership shall not be liable to an Indemnitee, other than for reasonable expenses actually incurred by the Indemnitee with respect to a proceeding in which (i) the Indemnitee is found liable on the basis that the Indemnitee improperly received personal benefit, whether or not the benefit resulted from an action taken in the Indemnitee's official capacity, or (ii) the Indemnitee is found liable to the Partnership or the Limited Partners. The Partnership shall not indemnify or hold harmless the Indemnitee: (a) in the case in which the Indemnitee is an Independent Director, if the loss or liability was the result of gross negligence or willful misconduct by the Indemnitee, or (b) in any other case, if the loss or liability was the result of negligence or misconduct by the Indemnitee. The termination of any proceeding by judgment, order or settlement does not create a presumption that the Indemnitee did not meet the requisite standard of conduct set forth in this Section 6.3(a). The termination of any proceeding by conviction or upon a plea of nolo contendere or its equivalent, or an entry of an order of probation prior to judgment, does not alone determine that the Indemnitee acted in a manner contrary to that specified in this Section 6.3(a). Any indemnification pursuant to this Section 6.3 shall be made only out of the assets of the Partnership.

(b) Notwithstanding anything to the contrary contained in the provisions of subsection (a) of this Section 6.3, the Partnership shall not provide indemnification for any loss, liability or expense arising from or out of an alleged violation of federal or state securities laws by an Indemnitee unless one or more of the following conditions are met: (i) there has been a successful adjudication on the merits of each count involving alleged securities law violations as to the particular Indemnitee, (ii) such claims have been dismissed with prejudice on the merits by a court of competent jurisdiction as to the particular Indemnitee, or (iii) a court of competent jurisdiction approves a settlement of the claims against a particular Indemnitee and finds that indemnification of the settlement and the related costs should be made, and the court considering the request for indemnification has been advised of the position of the Commission and of the published position of any state securities regulatory authority in which securities of the Partnership were offered or sold as to indemnification for violations of securities laws.

(c) The Partnership shall pay or reimburse reasonable legal expenses and other costs incurred by an Indemnitee in advance of final disposition of a proceeding if all of the following are satisfied: (i) the proceeding relates to acts or omissions with respect to the performance of duties for services on behalf of the Partnership, (ii) the Indemnitee provides the Partnership with written affirmation of the Indemnitee's good faith belief that the Indemnitee has met the standard of conduct necessary for indemnification by the Partnership as authorized in this Section 6.3, (iii) the legal proceeding was initiated by a third party who is not a stockholder of the General Partner or, if by a stockholder of the General Partner acting in his or her capacity as such, a court of competent jurisdiction approves such advancement, and (iv) the Indemnitee provides the Partnership with a written agreement to repay the amount paid or reimbursed by the Partnership, together with the applicable legal rate of interest thereon, if it is ultimately determined that the Indemnitee did not comply with the requisite standard of conduct and is not entitled to indemnification.

(d) The Indemnification provided by this Section 6.3 shall be in addition to any other rights to which an Indemnitee or any other Person may be entitled under any agreement, pursuant to any vote of the Partners, as a matter of law or otherwise, and shall continue as to an Indemnitee who has ceased to serve in such capacity.

(e) The Partnership may purchase and maintain insurance or establish other arrangements, including without limitation trust arrangements and letters of credit on behalf of or to secure indemnification obligations owed to the Indemnitees and such other Persons as the General Partner shall determine

against any liability that may be asserted against or expenses that may be incurred by such Person in connection with the Partnership's activities, regardless of whether the Partnership would have the power to indemnify such Person against such liability under the provisions of this Agreement.

(f) For purposes of this Section 6.3, (i) the Partnership shall be deemed to have requested an Indemnitee to serve as a fiduciary of an employee benefit plan whenever the performance by the Indemnitee of its duties to the Partnership also imposes duties on the Indemnitee, or otherwise involves services by the Indemnitee to the plan or participants or beneficiaries of the plan; (ii) excise taxes assessed on an Indemnitee with respect to an employee benefit plan pursuant to applicable law shall constitute fines within the meaning of this Section 6.3; and

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(iii) actions taken or omitted by the Indemnitee with respect to an employee benefit plan in the performance of its duties for a purpose reasonably believed by it to be in the interest of the participants and beneficiaries of the plan shall be deemed to be for a purpose which is not opposed to the best interests of the Partnership.

(g) In no event may an Indemnitee subject the Limited Partners to personal liability by reason of the indemnification provisions set forth in this Agreement.

(h) An Indemnitee shall not be denied indemnification in whole or in part under this Section 6.3 because the Indemnitee had an interest in the transaction with respect to which the indemnification applies if the transaction was otherwise permitted by the terms of this Agreement.

(i) The provisions of this Section 6.3 are for the benefit of the Indemnitees, their heirs, successors, assigns and administrators and shall not be deemed to create any rights in or be for the benefit of any other Persons.

(j) Any amendment, modification or repeal of this Section 6.3 or any provision hereof shall be prospective only and shall not in any way affect the indemnification of an Indemnitee by the Partnership under this Section 6.3 as in effect immediately prior to such amendment, modification or repeal with respect to matters occurring, in whole or in part, prior to such amendment, modification or repeal, regardless of when claims relating to such matters may arise or be asserted.

#### 6.4 LIABILITY OF THE GENERAL PARTNER.

(a) Notwithstanding anything to the contrary set forth in this Agreement, the General Partner shall not be liable for monetary damages to the Partnership or any Partners for losses sustained or liabilities incurred as a result of errors in judgment or any act or omission if the General Partner acted in good faith. The General Partner shall not be in breach of any duty that the General Partner may owe to the Limited Partners or the Partnership or any other Persons under this Agreement or of any duty stated or implied by law or equity, provided, the General Partner, acting in good faith, abides by the terms of this Agreement. In addition, to the extent the General Partner or any officer, director, employee, agent or stockholder of the General Partner performs its duties in accordance with the standards provided by the Act, as it may be amended from time to time, or under any successor statute thereto, such Person or Persons shall have no liability by reason of being or having been the General Partner, or by reason of being an officer, director, employee, agent or stockholder of the General Partner. To the maximum extent that the Act and the general laws of the State of Delaware, in effect from time to time, permit limitation of the liability of general partner of a limited partnership, the General Partner and its officers, directors, employees, agents and stockholders shall not be liable to the Partnership or to any Partner for money damages except to the extent that (i) the General Partner or its officers, directors, employees, agents or stockholders actually received an improper benefit or profit in money, property or services, in which case the liability shall not exceed the amount of the benefit or profit in money, property or services actually received; or (ii) a judgment or other final adjudication adverse to the General Partner or one or more of its officers, directors, employees, agents or stockholders is entered in a proceeding based on a finding in the proceeding that the action or failure to act of the General Partner or one or more of its officers, directors, employees, agents or stockholders was the result of active and deliberate dishonesty and was material to the cause of action adjudicated in the proceeding. Neither the amendment nor repeal of this Section 6.4(a), nor the adoption or amendment of any other provision of this Agreement inconsistent with this Section 6.4(a), shall apply to or affect in any respect the applicability of the preceding sentence with respect to any act or failure to act which occurred prior to such amendment, repeal or adoption. In the absence of any Delaware statute limiting the liability of the General Partner or its directors

or officers for money damages in a suit by or on behalf of the Partnership or by any Partner, the General Partner and the officers, directors, employees, agents and stockholders of the General Partner shall not be liable to the Partnership or to any Partner for money damages except to the extent that (i) the General Partner or one or more of its officers, directors, employees, agents or stockholders actually received an improper benefit or profit in money, property or services, in which case the liability shall not exceed the amount of the benefit or profit in money, property or services actually received; or (ii) a judgment or other final adjudication adverse to the General Partner or one or more of its officers, directors, employees, agents or stockholders is entered in a proceeding based on a finding in the proceeding that the action of the General Partner or one or more of its officers, directors, employees or stockholders action or failure to act was the result of active and deliberate dishonesty and was material to the cause of action adjudicated in the proceeding.

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(b) The Limited Partners expressly acknowledge that the General Partner is acting on behalf of the Partnership, itself and its stockholders collectively, that the General Partner is under no obligation to consider the separate interests of the Limited Partners (including, without limitation, the tax consequences to Limited Partners or the tax consequences of some, but not all, of the Limited Partners) in deciding whether to cause the Partnership to take (or decline to take) any actions. In the event of a conflict between the interests of its stockholders on the one hand and the Limited Partners on the other, the General Partner shall endeavor in good faith to resolve the conflict in a manner not adverse to either its stockholders or the Limited Partners; provided, however, that for so long as the General Partner directly owns a controlling interest in the Partnership, any such conflict that the General Partner, in its sole and absolute discretion, determines cannot be resolved in a manner not adverse to either its stockholders or the Limited Partners shall be resolved in favor of its stockholders. The General Partner shall not be liable for monetary damages for losses sustained, liabilities incurred, or benefits not derived by Limited Partners in connection with such decisions, provided that the General Partner has acted in good faith.

(c) Subject to its obligations and duties as General Partner set forth in Section 6.1 hereof, the General Partner may exercise any of the powers granted to it under this Agreement and perform any of the duties imposed upon it hereunder either directly or by or through its agents. The General Partner shall not be responsible for any misconduct or negligence on the part of any such agent appointed by it in good faith.

(d) Notwithstanding any other provisions of this Agreement or the Act, any action of the General Partner on behalf of the Partnership or any decision of the General Partner to refrain from acting on behalf of the Partnership, undertaken in the good faith belief that such action or omission is necessary or advisable in order to (i) protect the ability of the General Partner to continue to qualify as a REIT or (ii) prevent the General Partner from incurring any taxes under Section 857, Section 4981, or any other provision of the Code, is expressly authorized under this Agreement and is deemed approved by all of the Limited Partners.

(e) Any amendment, modification or repeal of this Section 6.4 or any provision hereof shall be prospective only and shall not in any way affect the limitations on the General Partner's liability to the Partnership and the Limited Partners under this Section 6.4 as in effect immediately prior to such amendment, modification or repeal with respect to matters occurring, in whole or in part, prior to such amendment, modification or repeal, regardless of when claims relating to such matters may arise or be asserted.

#### 6.5 REIMBURSEMENT OF GENERAL PARTNER.

(a) Except as provided in this Section 6.5 and elsewhere in this Agreement (including the provisions of Articles 5 and 6 regarding distributions, payments, and allocations to which it may be entitled), the General Partner shall not be compensated for its services as general partner of the Partnership.

(b) The General Partner shall be reimbursed on a monthly basis, or such other basis as the General Partner may determine in its sole and absolute discretion, for all REIT Expenses and Administrative Expenses.

6.6 OUTSIDE ACTIVITIES. Subject to Section 6.8 hereof, the Articles of Incorporation and any agreements entered into by the General Partner or its Affiliates with the Partnership or a Subsidiary, or any officer, director, employee, agent, trustee, Affiliate or stockholder of the General Partner, the General Partner shall be entitled to and may have business interests and engage in business activities in addition to those relating to the Partnership, including business interests and activities substantially similar or identical to those of the Partnership. Neither the Partnership nor any of the Limited

Partners shall have any rights by virtue of this Agreement in any such business ventures, interests or activities. None of the Limited Partners or any other Person shall have any rights by virtue of this Agreement or the partnership relationship established hereby in any such business ventures, interests or activities, and the General Partner shall have no obligation pursuant to this Agreement to offer any interest in any such business ventures, interests and activities to the Partnership or any Limited Partner, even if such opportunity is of a character which, if presented to the Partnership or any Limited Partner, could be taken by such Person.

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#### 6.7 EMPLOYMENT OR RETENTION OF AFFILIATES.

(a) Any Affiliate of the General Partner may be employed or retained by the Partnership and may otherwise deal with the Partnership (whether as an adviser, buyer, lessor, lessee, manager, property management agent, asset manager, furnisher of goods or services, broker, agent, lender or otherwise) and may receive from the Partnership any compensation, price, or other payment therefor which the General Partner determines to be fair and reasonable.

(b) The Partnership may lend or contribute to its Subsidiaries or other Persons in which it has an equity investment, and such Persons may borrow funds from the Partnership, on terms and conditions established in the sole and absolute discretion of the General Partner. The foregoing authority shall not create any right or benefit in favor of any Subsidiary or any other Person.

(c) The Partnership may transfer assets to joint ventures, limited liability companies, other partnerships, corporations or other business entities in which it is or thereby becomes a participant upon such terms and subject to such conditions as the General Partner deems to be consistent with this Agreement and applicable law.

(d) Except as expressly permitted by this Agreement, neither the General Partner nor any of its Affiliates shall sell, transfer or convey any property to, or purchase any property from, the Partnership, directly or indirectly, except pursuant to transactions that are on terms that are fair and reasonable to the Partnership.

6.8 GENERAL PARTNER PARTICIPATION. The General Partner agrees that all business activities of the General Partner, including activities pertaining to the acquisition, development or ownership of industrial or commercial real property or other property, including Mortgages, shall be conducted through the Partnership or one or more Subsidiary Partnerships; provided, however, that the General Partner is allowed to make a direct acquisition, but if and only if, such acquisition is made in connection with the issuance of Additional Securities, which direct acquisition and issuance have been approved and determined to be in the best interests of the General Partner and the Partnership by a majority of the Independent Directors.

6.9 TITLE TO PARTNERSHIP ASSETS. Partnership assets, whether real, personal or mixed and whether tangible or intangible, shall be deemed to be owned by the Partnership as an entity, and no Partner, individually or collectively, shall have any ownership interest in such Partnership assets or any portion thereof; provided, that title to any or all of the Partnership assets may be held in the name of the Partnership, the General Partner or one or more nominees, as the General Partner may determine, including Affiliates of the General Partner. The General Partner hereby declares and warrants that any Partnership assets for which legal title is held in the name of the General Partner or any nominee or Affiliate of the General Partner shall be held by such Person for the use and benefit of the Partnership in accordance with the provisions of this Agreement; provided, that the General Partner shall use its best efforts to cause legal title to such assets to be vested in the Partnership as soon as reasonably practicable. All Partnership assets shall be recorded as the property of the Partnership in its books and records, irrespective of the name in which legal title to such Partnership assets is held.

6.10 REDEMPTION OF GENERAL PARTNER PARTNERSHIP UNITS. In the event the General Partner redeems any REIT Shares or REIT Preferred Shares, then the General Partner shall cause the Partnership to purchase from the General Partner or the Original Limited Partner a number of Common Units or Preferred Units, as the case may be, on the same terms upon which the General Partner redeemed such REIT Shares or REIT Preferred Shares. Moreover, if the General Partner makes a cash tender offer or other offer to acquire REIT Shares or REIT Preferred Shares or otherwise purchases REIT Shares or REIT Preferred Shares, then the General Partner shall cause the Partnership to make a corresponding offer to the General Partner or the Original Limited Partner to acquire, or shall otherwise purchase, an equal number of Common Units or Preferred Units, as the case may be, held by the General Partner or Original Limited Partner. In the event any REIT Shares or REIT Preferred Shares are redeemed by the General Partner pursuant to such offer, the Partnership shall redeem an equivalent number of the

General Partner's or the Original Limited Partner's Common Units or Preferred Units, as the case may be, for an equivalent purchase price.

## ARTICLE 7

### CHANGES IN GENERAL PARTNER

#### 7.1 TRANSFER OF THE GENERAL PARTNER'S PARTNERSHIP INTEREST.

(a) The General Partner shall not transfer all or any portion of its General Partnership Interest or withdraw as General Partner except as provided in or in connection with a transaction contemplated by Sections 7.1(c), 7.1(d) or 7.1(e).

(b) The General Partner agrees that the Percentage Interest for it will at all times, be in the aggregate, at least 0.2%.

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(c) Except as otherwise provided in Section 7.1(d) or (e) hereof, the General Partner shall not engage in any merger, consolidation or other combination with or into another Person or sale of all or substantially all of its assets (other than in connection with a change in the General Partner's state of incorporation or organizational form), which, in any such case, results in a change of control of the General Partner (a "TRANSACTION"), unless:

(i) the consent of Limited Partners (other than the General Partner or any Subsidiary) holding more than 50% of the Percentage Interests of the Limited Partners (other than those held by the General Partner or any Subsidiary) is obtained; or

(ii) as a result of such Transaction all Limited Partners are granted the right to receive for each Partnership Unit an amount of cash, securities, or other property equal to the product of the Conversion Factor and the greatest amount of cash, securities or other property paid in the Transaction to a holder of one REIT Share in consideration of the transfer of one REIT Share; provided, that if, in connection with the Transaction, a purchase, tender or exchange offer ("OFFER") shall have been made to and accepted by the holders of more than 50% of the outstanding REIT Shares, each holder of Partnership Units shall be given the option to exchange its Partnership Units for the greatest amount of cash, securities, or other property which a Limited Partner would have received had it (A) exercised its Exchange Right and (B) sold, tendered or exchanged pursuant to the Offer the REIT Shares received upon exercise of the Exchange Right immediately prior to the expiration of the Offer; or

(iii) the General Partner is the surviving entity in the Transaction and either (A) the holders of REIT Shares do not receive cash, securities, or other property in the Transaction or (B) all Limited Partners (other than the General Partner or any Subsidiary) receive an amount of cash, securities, or other property (expressed as an amount per REIT Share) that is no less than the product of the Conversion Factor and the greatest amount of cash, securities, or other property (expressed as an amount per REIT Share) received in the Transaction by any holder of REIT Shares.

(d) Notwithstanding Section 7.1(c), the General Partner may merge with or into or consolidate with another entity if immediately after such merger or consolidation (i) substantially all of the assets of the successor or surviving entity (the "Survivor"), other than Partnership Units held by the General Partner, are contributed, directly or indirectly, to the Partnership as a Capital Contribution in exchange for Partnership Units with a fair market value equal to the value of the assets so contributed as determined by the Survivor in good faith and (ii) the Survivor expressly agrees to assume all obligations of the General Partner, as appropriate, hereunder. Upon such contribution and assumption, the Survivor shall have the right and duty to amend this Agreement as set forth in this Section 7.1(d). The Survivor shall in good faith arrive at a new method for the calculation of the Cash Amount, the REIT Shares Amount and the Conversion Factor for a Partnership Unit after any such merger or consolidation so as to approximate the existing method for such calculation as closely as reasonably possible. Such calculation shall take into account, among other things, the kind and amount of securities, cash and other property that was receivable upon such merger or consolidation by a holder of REIT Shares or options, warrants or other rights relating thereto, and which a holder of Partnership Units could have acquired had such Partnership Units been exchanged immediately prior to such merger or consolidation. Such amendment to this Agreement shall provide for adjustments to such method of calculation, which shall be as nearly equivalent as may be practicable to the adjustments provided for herein with respect to the Conversion Factor. The Survivor also shall in good faith modify the definition of REIT Shares and make such

amendments to Section 8.5 hereof so as to approximate the existing rights and obligations set forth in Section 8.5 as closely as reasonably possible. The above provisions of this Section 7.1(d) shall similarly apply to successive mergers or consolidations permitted hereunder.

In respect of any transaction described in the preceding paragraph, the General Partner is required to use its commercially reasonable efforts to structure such transaction to avoid causing the Limited Partners to recognize a gain for federal income tax purposes by virtue of the occurrence of or their participation in such transaction, provided, such efforts are consistent with the exercise of the Board of Directors' fiduciary duties to the stockholders of the General Partner under applicable law.

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(e) Notwithstanding anything in this Article 7,

(i) a General Partner may transfer all or any portion of its General Partnership Interest to (A) a wholly-owned Subsidiary of such General Partner or (B) the owner of all of the ownership interests of such General Partner, and following a transfer of all of its General Partnership Interest, may withdraw as General Partner; and

(ii) the General Partner may engage in a transaction not required by law or by the rules of any national securities exchange on which the REIT Shares are listed to be submitted to the vote of the holders of the REIT Shares.

7.2 ADMISSION OF A SUBSTITUTE OR ADDITIONAL GENERAL PARTNER. A Person shall be admitted as a substitute or additional General Partner of the Partnership only if the following terms and conditions are satisfied:

(a) the Person to be admitted as a substitute or additional General Partner shall have accepted and agreed to be bound by all the terms and provisions of this Agreement by executing a counterpart hereof and such other documents or instruments as may be required or appropriate in order to effect the admission of such Person as a General Partner, a certificate evidencing the admission of such Person as a General Partner shall have been filed for recordation and all other actions required by Section 2.5 hereof in connection with such admission shall have been performed;

(b) if the Person to be admitted as a substitute or additional General Partner is a corporation or a partnership, it shall have provided the Partnership with evidence satisfactory to counsel for the Partnership of such Person's authority to become a General Partner and to be bound by the terms and provisions of this Agreement; and

(c) counsel for the Partnership shall have rendered an opinion (relying on such opinions from other counsel in the state or any other jurisdiction as may be necessary) that the admission of the Person to be admitted as a substitute or additional General Partner is in conformity with the Act, and that none of the actions taken in connection with the admission of such Person as a substitute or additional General Partner will cause (i) the Partnership to be classified other than as a partnership for federal income tax purposes, or (ii) the loss of any Limited Partner's limited liability.

7.3 EFFECT OF BANKRUPTCY, WITHDRAWAL, DEATH OR DISSOLUTION OF A GENERAL PARTNER.

(a) Upon the occurrence of an Event of Bankruptcy as to a General Partner (and its removal pursuant to Section 7.4(a) hereof) or the death, withdrawal, removal or dissolution of a General Partner (except that, if a General Partner is, on the date of such occurrence a partnership, the withdrawal, death, dissolution, Event of Bankruptcy as to, or removal of a partner in, such partnership shall be deemed not to be a dissolution of such General Partner if the business of such General Partner is continued by the remaining partner or partners thereof), the Partnership shall be dissolved and terminated unless the Partnership is continued pursuant to Section 7.3(b) hereof. The merger of the General Partner with or into any entity that is admitted as a substitute or successor General Partner pursuant to Section 7.2 hereof shall not be deemed to be the withdrawal, dissolution or removal of the General Partner.

(b) Following the occurrence of an Event of Bankruptcy as to a General Partner (and its removal pursuant to Section 7.4(a) hereof) or the death, withdrawal, removal or dissolution of a General Partner (except that, if a General Partner is, on the date of such occurrence a partnership, the withdrawal, death, dissolution, Event of Bankruptcy as to, or removal of a partner in, such partnership shall be deemed not to be a dissolution of such General Partner if the business of such General Partner is continued by the remaining partner or partners thereof), the Limited Partners, within 90 days

after such occurrence, may elect to continue the business of the Partnership for the balance of the term specified in Section 2.4 hereof by selecting, subject to Section 7.2 hereof and any other provisions of this Agreement, a substitute General Partner by consent of a majority in interest of the Limited Partners. If the Limited Partners elect to continue the business of the Partnership and admit a substitute General Partner, the relationship with the Partners and of any Person who has acquired an interest of a Partner in the Partnership shall be governed by this Agreement.

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#### 7.4 REMOVAL OF A GENERAL PARTNER.

(a) Upon the occurrence of an Event of Bankruptcy as to, or the dissolution of, a General Partner, such General Partner shall be deemed to be removed automatically; provided, however, that if a General Partner is on the date of such occurrence a partnership, the withdrawal, death, dissolution, Event of Bankruptcy as to or removal of a partner in such partnership shall be deemed not to be a dissolution of the General Partner if the business of such General Partner is continued by the remaining partner or partners thereof. The Limited Partners may not remove the General Partner, with or without cause.

(b) If a General Partner has been removed pursuant to this Section 7.4 and the Partnership is continued pursuant to Section 7.3 hereof, such General Partner shall promptly transfer and assign its General Partnership Interest in the Partnership to the substitute General Partner approved by a majority in interest of the Limited Partners in accordance with Section 7.3(b) hereof and otherwise admitted to the Partnership in accordance with Section 7.2 hereof. At the time of assignment, the removed General Partner shall be entitled to receive from the substitute General Partner the fair market value of the General Partnership Interest of such removed General Partner as reduced by any damages caused to the Partnership by such General Partner's removal. Such fair market value shall be determined by an appraiser mutually agreed upon by the General Partner and Limited Partners holding more than 50% of the Percentage Interests of the Limited Partners within 10 days following the removal of the General Partner. In the event that the parties are unable to agree upon an appraiser, the removed General Partner and Limited Partners holding more than 50% of the Percentage Interests of the Limited Partners shall each select an appraiser. Each such appraiser shall complete an appraisal of the fair market value of the removed General Partner's General Partnership Interest within 30 days of the General Partner's removal, and the fair market value of the removed General Partner's General Partnership Interest shall be the average of the two appraisals; provided, however, that if the higher appraisal exceeds the lower appraisal by more than 20% of the amount of the lower appraisal, the two appraisers, no later than 40 days after the removal of the General Partner, shall select a third appraiser who shall complete an appraisal of the fair market value of the removed General Partner's General Partnership Interest no later than 60 days after the removal of the General Partner. In such case, the fair market value of the removed General Partner's General Partnership Interest shall be the average of the two appraisals closest in value.

(c) The General Partnership Interest of a removed General Partner, during the time after removal until the date of transfer under Section 7.4(b), shall be converted to that of a special Limited Partner; provided, however, such removed General Partner shall not have any rights to participate in the management and affairs of the Partnership, and shall not be entitled to any portion of the income, expense, Profit, gain or Loss allocations or cash distributions allocable or payable, as the case may be, to the Limited Partners. Instead, such removed General Partner shall receive and be entitled only to retain distributions or allocations of such items that it would have been entitled to receive in its capacity as General Partner, until the transfer is effective pursuant to Section 7.4(b).

(d) All Partners shall have given and hereby do give such consents, shall take such actions and shall execute such documents as shall be legally necessary and sufficient to effect all the foregoing provisions of this Section 7.4.

### ARTICLE 8

#### RIGHTS AND OBLIGATIONS OF THE LIMITED PARTNERS

8.1 MANAGEMENT OF THE PARTNERSHIP. The Limited Partners shall not participate in the management or control of Partnership business nor shall they transact any business for or on behalf of the Partnership, nor shall they have the power to sign for or bind the Partnership, such powers being vested solely and exclusively in the General Partner.

8.2 POWER OF ATTORNEY. Each Limited Partner hereby irrevocably appoints

the General Partner its true and lawful attorney-in-fact, who may act for each Limited Partner and in its name, place and stead, and for its use and benefit, sign, acknowledge, swear to, deliver, file or record, at the appropriate public offices, any and all

documents, certificates, and instruments as may be deemed necessary or desirable by the General Partner to carry out fully the provisions of this Agreement and the Act in accordance with their terms, which power of attorney is coupled with an interest and shall survive the death, dissolution or legal incapacity of the Limited Partner, or the transfer by the Limited Partner of any part or all of its Partnership Interest.

8.3 LIMITATION ON LIABILITY OF LIMITED PARTNERS. No Limited Partner shall be liable for any debts, liabilities, contracts or obligations of the Partnership. A Limited Partner shall be liable to the Partnership only to make payments of its Capital Contribution, if any, as and when due hereunder. After its Capital Contribution is fully paid, no Limited Partner shall, except as otherwise required by the Act, be required to make any further Capital Contributions or other payments or lend any funds to the Partnership.

8.4 OWNERSHIP BY LIMITED PARTNER OF CORPORATE GENERAL PARTNER OR AFFILIATE. No Limited Partner shall at any time, either directly or indirectly, own any stock or other interest in the General Partner or in any Affiliate thereof, if such ownership by itself or in conjunction with other stock or other interests owned by other Limited Partners would, in the opinion of counsel for the Partnership, jeopardize the classification of the Partnership as a partnership for federal income tax purposes. The General Partner shall be entitled to make such reasonable inquiry of the Limited Partners as is required to establish compliance by the Limited Partners with the provisions of this Section 8.4.

#### 8.5 EXCHANGE RIGHT.

(a) Subject to Sections 8.5(b), 8.5(c), 8.5(d) and 8.5(e) hereof, and subject to the potential modification of any rights or obligations provided for herein by agreement(s) between the Partnership and any one or more Limited Partners with respect to Partnership Units held by them, each Limited Partner which is not a Subsidiary of the General Partner shall have the right (the "EXCHANGE RIGHT") to require the Partnership to redeem on a Specified Exchange Date all or a portion of the Partnership Units held by such Limited Partner at an exchange price equal to and in the form of the Exchange Amount to be paid by the Partnership; provided, that such redemption shall not occur before the date that is one year following the closing of the initial public offering of shares of the General Partner's common stock, subject to any restriction agreed to in writing between the Limited Partner who is exercising the Exchange Right (the "EXCHANGING PARTNER") and the General Partner. The Exchange Right shall be exercised pursuant to the delivery of an Exchange Notice to the Partnership (with a copy to the General Partner) by the Exchanging Partner; provided, however, that the Partnership shall, in its sole and absolute discretion, have the option to deliver either the Cash Amount or the REIT Shares Amount; provided, further, that the Partnership shall not be obligated to satisfy such Exchange Right if the General Partner elects to purchase the Partnership Units subject to the Exchange Notice; and provided further, that no Limited Partner may deliver more than two Exchange Notices during each calendar year. A Limited Partner may not exercise the Exchange Right for less than 1,000 Partnership Units or, if such Limited Partner holds less than 1,000 Partnership Units, all of the Partnership Units held by such Partner. The Exchanging Partner shall have no right, with respect to any Partnership Units so exchanged, to receive any distribution paid with respect to such Partnership Units if the record date for such distribution is on or after the Specified Exchange Date.

(b) Notwithstanding the provisions of Section 8.5(a), a Limited Partner that exercises the Exchange Right shall be deemed to have also offered to sell the Partnership Units described in the Exchange Notice to the General Partner, and the General Partner may, in its sole and absolute discretion, elect to purchase directly and acquire such Partnership Units by paying to the Exchanging Partner either the Cash Amount or the REIT Shares Amount, as elected by the General Partner (in its sole and absolute discretion), on the Specified Exchange Date, whereupon the General Partner shall acquire the Partnership Units offered for exchange by the Exchanging Partner and shall be treated for all purposes of this Agreement as the owner of such Partnership Units. If the General Partner shall elect to exercise its right to purchase Partnership Units under this Section 8.5(b) with respect to an Exchange Notice, it shall so notify the Exchanging Partner within five business days after the receipt by the General Partner of such Exchange Notice. Unless the General Partner (in its sole and absolute discretion) shall exercise its right to purchase Partnership Units from the Exchanging Partner pursuant to this Section



8.5(b), the General Partner shall have no obligation to the Exchanging Partner or the Partnership with respect to the Exchanging Partner's exercise of an Exchange Right. In the event the General Partner shall exercise its right to purchase Partnership Units with respect to the exercise of an Exchange Right in the manner described in the first sentence of this Section 8.5(b), the Partnership shall have no obligation to pay any amount to the Exchanging Partner with respect to such Exchanging

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Partner's exercise of such Exchange Right, and each of the Exchanging Partner and the General Partner shall treat the transaction between the General Partner and the Exchanging Partner for federal income tax purposes as a sale of the Exchanging Partner's Partnership Units to the General Partner. Each Exchanging Partner agrees to execute such documents as the General Partner may reasonably require in connection with the issuance of REIT Shares to such Exchanging Partner upon exercise of its Exchange Right.

(c) Notwithstanding the provisions of Sections 8.5(a) and 8.5(b), a Limited Partner shall not be entitled to exercise the Exchange Right if the delivery of REIT Shares to such Partner on the Specified Exchange Date by the General Partner pursuant to Section 8.5(b) (regardless of whether or not the General Partner would in fact exercise its rights under Section 8.5(b)) would (i) result in such Partner or any other person owning, directly or indirectly, REIT Shares in excess of the ownership limitations described in the Articles of Incorporation and calculated in accordance therewith, (ii) result in REIT Shares being owned by fewer than 100 persons (determined without reference to any rules of attribution), except as provided in the Articles of Incorporation, (iii) result in the General Partner being "closely held" within the meaning of Section 856(h) of the Code, (iv) cause the General Partner to own, directly or constructively, 10% or more of the ownership interests in a tenant of the General Partner's, the Partnership's, or a Subsidiary Partnership's real property within the meaning of Section 856(d)(2)(B) of the Code, or (v) cause the acquisition of REIT Shares by such Partner to be "integrated" with any other distribution of REIT Shares for purposes of complying with the registration provisions of the Securities Act. The General Partner, in its sole and absolute discretion, may waive any of the restrictions on exchange set forth in this Section 8.5(c); provided, however, that in the event any such restriction is waived, the Exchanging Partner shall be paid the Cash Amount.

(d) Any Cash Amount to be paid to an Exchanging Partner pursuant to this Section 8.5 shall be paid on the Specified Exchange Date; provided, however, that the General Partner may elect to cause the Specified Exchange Date to be delayed for up to 180 days to the extent required for the General Partner to cause additional REIT Shares to be issued to provide financing to be used to make such payment of the Cash Amount or otherwise. Notwithstanding the foregoing, the General Partner agrees to use its best efforts to cause the closing of the acquisition of exchanged Partnership Units hereunder to occur as quickly as reasonably possible.

(e) Notwithstanding any other provision of this Agreement, the General Partner is authorized to take any action that it determines to be necessary or appropriate to cause the Partnership to comply with any withholding requirements established under the Code or any other federal, state or local law that apply upon an Exchanging Partner's exercise of the Exchange Right. If an Exchanging Partner believes that it is exempt from such withholding upon the exercise of the Exchange Right, such Partner must furnish the General Partner with a FIRPTA Certificate in the form attached hereto as Exhibit C. If the Partnership or the General Partner is required to withhold and pay over to any taxing authority any amount upon an Exchanging Partner's exercise of the Exchange Right and if the Exchange Amount equals or exceeds the amount required to be withheld, the amount required to be withheld shall be treated as an amount received by such Partner upon exchange of its Partnership Units. If, however, the Exchange Amount is less than the amount required to be withheld, the Exchanging Partner shall not receive any portion of the Exchange Amount, the Exchange Amount shall be treated as an amount received by such Partner upon exchange of its Partnership Units, and the Partner shall contribute the excess of the amount withheld over the Exchange Amount to the Partnership before the Partnership is required to pay over such excess to a taxing authority.

(f) Notwithstanding any other provision of this Agreement, the General Partner shall place appropriate restrictions on the ability of the Limited Partners to exercise their Exchange Rights as and if deemed necessary to ensure that the Partnership does not constitute a "publicly traded partnership" under Section 7704 of the Code. If and when the General Partner determines that imposing such restrictions is necessary, the General Partner shall give prompt written notice thereof (a "RESTRICTION NOTICE") to each of the Limited Partners, which notice shall be accompanied by a copy of an opinion of counsel to the Partnership which states that, in the opinion of such counsel, restrictions are necessary in order to avoid the Partnership being treated as a "publicly traded partnership" under Section 7704 of the Code.

8.6 DUTIES AND CONFLICTS. The General Partner recognizes that the

Limited Partners and their Affiliates have or may have other business interests, activities and investments, some of which may be in conflict or competition with the business of the Partnership, and that such Persons are entitled to carry on such other business interests, activities and investments. The Limited Partners and their Affiliates may engage in or possess an interest in

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any other business or venture of any kind, independently or with others, on their own behalf or on behalf of other entities with which they are affiliated or associated, and such Persons may engage in any activities, whether or not competitive with the Partnership, without any obligation to offer any interest in such activities to the Partnership or to any Partner. Neither the Partnership nor any Partner shall have any right, by virtue of this Agreement, in or to such activities, or the income or profits derived therefrom, and the pursuit of such activities, even if competitive with the business of the Partnership, and such activities shall not be deemed wrongful or improper.

## ARTICLE 9

### TRANSFERS OF LIMITED PARTNERSHIP INTERESTS

#### 9.1 PURCHASE FOR INVESTMENT.

(a) Each Limited Partner hereby represents and warrants to the General Partner and to the Partnership that the acquisition of its Partnership Interest is made as a principal for its account for investment purposes only and not with a view to the resale or distribution of such Partnership Interest.

(b) Each Limited Partner agrees that it will not sell, assign or otherwise transfer its Partnership Interest or any fraction thereof, whether voluntarily or by operation of law or at judicial sale or otherwise, to any Person who does not make the representations and warranties to the General Partner set forth in Section 9.1(a) above.

#### 9.2 RESTRICTIONS ON TRANSFER OF LIMITED PARTNERSHIP INTERESTS.

(a) Subject to the provisions of Sections 9.2(b), 9.2(c) and 9.2(d), no Limited Partner may offer, sell, assign, hypothecate, pledge or otherwise transfer all or any portion of its Limited Partnership Interest, or any of such Limited Partner's economic rights as a Limited Partner, whether voluntarily or by operation of law or at judicial sale or otherwise (collectively, a "TRANSFER"), without the consent of the General Partner, which consent may be granted or withheld in its sole and absolute discretion. Any such purported transfer undertaken without such consent shall be considered to be null and void ab initio and shall not be given effect. The General Partner may require, as a condition of any Transfer to which it consents, that the transferor assume all costs incurred by the Partnership in connection therewith.

(b) No Limited Partner may withdraw from the Partnership other than as a result of: (i) a permitted Transfer (i.e., a Transfer consented to as contemplated by paragraph (a) above or paragraph (c) below or a Transfer made pursuant to Section 9.5 below) of all of its Partnership Units pursuant to this Article 9 or (ii) a Transfer pursuant to an exchange of all of its Partnership Units pursuant to Section 8.5 above. Upon the permitted Transfer or exchange of all of a Limited Partner's Partnership Units, such Limited Partner shall cease to be a Limited Partner.

(c) Subject to Sections 9.2(d) and 9.2(e), a Limited Partner may Transfer, with the consent of the General Partner, all or a portion of its Partnership Units to (i) a parent or parent's spouse, natural or adopted descendants, a spouse of any such descendant, a brother or sister, or a trust created by such Limited Partner for the benefit of such Limited Partner and/or any such person(s), for which trust such Limited Partner or any such person(s) is a trustee, (ii) a corporation controlled by a Person or Persons named in (i) above, or (iii) if the Limited Partner is an entity, its beneficial owners.

(d) No Limited Partner may effect a Transfer of its Limited Partnership Interest, in whole or in part, if, in the opinion of legal counsel for the Partnership, such proposed Transfer would require the registration of the Limited Partnership Interest under the Securities Act, or would otherwise violate any applicable federal or state securities or blue sky law (including investment suitability standards).

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(e) No Transfer by a Limited Partner of its Partnership Units, in whole or in part, may be made to any Person if (i) in the opinion of legal counsel for the Partnership, the transfer would result in the Partnership's being treated as an association taxable as a corporation (other than a qualified REIT subsidiary within the meaning of Section 856(i) of the Code), (ii) in the opinion of legal counsel for the Partnership, it would adversely affect the ability of the General Partner to continue to qualify as a REIT or subject the General Partner to any additional taxes under Section 857 or Section 4981 of the Code, or (iii) in the opinion of legal counsel for the Partnership, such would cause the Partnership to be treated as a "publicly traded partnership" within the meaning of Section 7704 of the Code.

(f) Any Transfer in contravention of any of the provisions of this Article 9 shall be void ab initio and ineffectual and shall not be binding upon, or recognized by, the General Partner or the Partnership.

(g) Prior to the consummation of any Transfer under this Article 9, the transferor and/or the transferee shall deliver to the General Partner such opinions, certificates and other documents as the General Partner shall request in connection with such Transfer.

### 9.3 ADMISSION OF SUBSTITUTE LIMITED PARTNER.

(a) Subject to the other provisions of this Article 9, an assignee of the Limited Partnership Interest of a Limited Partner (which shall be understood to include any purchaser, transferee, donee or other recipient of any disposition of such Limited Partnership Interest) shall be deemed admitted as a Limited Partner of the Partnership only with the consent of the General Partner and upon the satisfactory completion of the following:

(i) the assignee shall have accepted and agreed to be bound by the terms and provisions of this Agreement by executing a counterpart or an amendment thereof, including a revised Exhibit A, and such other documents or instruments as the General Partner may require in order to effect the admission of such Person as a Limited Partner;

(ii) to the extent required, an amended Certificate evidencing the admission of such Person as a Limited Partner shall have been signed, acknowledged and filed for record in accordance with the Act;

(iii) the assignee shall have delivered a letter containing the representation set forth in Section 9.1(a) hereof and the agreement set forth in Section 9.1(b) hereof;

(iv) if the assignee is a corporation, partnership or trust, the assignee shall have provided the General Partner with evidence satisfactory to counsel for the Partnership of the assignee's authority to become a Limited Partner under the terms and provisions of this Agreement;

(v) the assignee shall have executed a power of attorney containing the terms and provisions set forth in Section 8.2 hereof;

(vi) the assignee shall have paid all legal fees and other expenses of the Partnership and the General Partner and filing and publication costs in connection with its substitution as a Limited Partner; and

(vii) the assignee shall have obtained the prior written consent of the General Partner to its admission as a Substitute Limited Partner, which consent may be given or denied in the exercise of the General Partner's sole and absolute discretion.

(b) For the purpose of allocating Profit and Loss and distributing cash received by the Partnership, a Substitute Limited Partner shall be treated as having become, and appearing in the records of the Partnership as, a Partner upon the filing of the Certificate described in Section 9.3(a)(ii) hereof or, if no such filing is required, the later of the date specified in the transfer documents or the date on which the General Partner has received all necessary instruments of transfer and substitution.

(c) The General Partner shall cooperate with the Person seeking to become a Substitute Limited Partner by preparing the documentation required by this Section 9.3 and making all official filings and publications. The Partnership shall take all such action as promptly as practicable after the satisfaction of the conditions in this Article 9 to the admission of such Person as a Limited Partner of the Partnership.

### 9.4 RIGHTS OF ASSIGNEES OF PARTNERSHIP INTERESTS.

(a) Subject to the provisions of Sections 9.1 and 9.2 hereof, except as required by operation of law, the Partnership shall not be obligated for any purposes whatsoever to recognize the assignment by any Limited Partner of its Partnership Interest until the Partnership has received notice thereof.

(b) Any Person who is the assignee of all or any portion of a Limited Partner's Limited Partnership Interest, but who does not become a Substitute Limited Partner and desires to make a further assignment of such Limited Partnership Interest, shall be subject to all the provisions of this Article 9 to the same extent and in the same manner as any Limited Partner desiring to make an assignment of its Limited Partnership Interest.

9.5 EFFECT OF BANKRUPTCY, DEATH, INCOMPETENCE OR TERMINATION OF A LIMITED PARTNER. The occurrence of an Event of Bankruptcy as to a Limited Partner, the death of a Limited Partner or a final adjudication that a Limited Partner is incompetent (which term shall include, but not be limited to, insanity) shall not cause the termination or dissolution of the Partnership, and the business of the Partnership shall continue if an order for relief in a bankruptcy proceeding is entered against a Limited Partner, the trustee or receiver of his estate or, if he dies, his executor, administrator or trustee, or, if he is finally adjudicated incompetent, his committee, guardian or conservator, and any such Person shall have the rights of such Limited Partner for the purpose of settling or managing his estate property and such power as the bankrupt, deceased or incompetent Limited Partner possessed to assign all or any part of his Partnership Interest and to join with the assignee in satisfying conditions precedent to the admission of the assignee as a Substitute Limited Partner.

9.6 JOINT OWNERSHIP OF INTERESTS. A Partnership Interest may be acquired by two individuals as joint tenants with right of survivorship, provided, that such individuals either are married or are related and share the same personal residence. The written consent or vote of both owners of any such jointly-held Partnership Interest shall be required to constitute the action of the owners of such Partnership Interest; provided, however, that the written consent of only one joint owner will be required if the Partnership has been provided with evidence satisfactory to the counsel for the Partnership that the actions of a single joint owner can bind both owners under the applicable laws of the state of residence of such joint owners. Upon the death of one owner of a Partnership Interest held in a joint tenancy with a right of survivorship, the Partnership Interest shall become owned solely by the survivor as a Limited Partner and not as an assignee. The Partnership need not recognize the death of one of the owners of a jointly held Partnership Interest until it shall have received notice of such death. Upon notice to the General Partner from either owner, the General Partner shall cause the Partnership Interest to be divided into two equal Partnership Interests, which shall thereafter be owned separately by each of the former joint owners.

## ARTICLE 10

### BOOKS AND RECORDS; ACCOUNTING; TAX MATTERS

10.1 BOOKS AND RECORDS. At all times during the continuance of the Partnership, the Partners shall keep or cause to be kept at the Partnership's specified office true and complete books of account maintained in accordance with generally accepted accounting principles, including (a) a current list of the full name and last-known business address of each Partner; (b) a copy of the Certificate of Limited Partnership and all certificates of amendment thereto; (c) copies of the Partnership's federal, state and local income tax returns and reports; (d) copies of the Agreement and any financial statements of the Partnership for the three most recent years; and (e) all documents and information required under the Act. Any Partner or its duly authorized representative, and any stockholder of the General Partner, upon paying the costs of collection, duplication and mailing, shall be entitled to inspect or copy such records during ordinary business hours.

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### 10.2 CUSTODY OF PARTNERSHIP FUNDS; BANK ACCOUNTS.

(a) All funds of the Partnership not otherwise invested shall be deposited in one or more accounts maintained in such banking or brokerage institutions as the General Partner shall determine, and withdrawals shall be made only on such signature or signatures as the General Partner may, from time to time, determine.

(b) All deposits and other funds not needed in the operation of the business of the Partnership may be invested by the General Partner in investment grade instruments (or investment companies whose portfolio consists primarily thereof), government obligations, certificates of deposit, bankers' acceptances and municipal notes and bonds. The funds of the Partnership shall

not be commingled with the funds of any other Person except for such commingling as may necessarily result from an investment in those investment companies permitted by this Section 10.2(b).

10.3 FISCAL AND TAXABLE YEAR. The fiscal and taxable year of the Partnership shall be the calendar year.

10.4 ANNUAL TAX INFORMATION AND REPORT. The General Partner will use commercially reasonable efforts to supply within 75 days after the end of each fiscal year of the Partnership to each person who was a Limited Partner at any time during such year the tax information necessary to file such Limited Partner's individual tax returns as shall be reasonably required by law, and in all events the General Partner shall furnish such information within the time required by applicable law.

10.5 TAX MATTERS PARTNER; TAX ELECTIONS; SPECIAL BASIS ADJUSTMENTS.

(a) The General Partner shall be the Tax Matters Partner of the Partnership within the meaning of Section 6231(a)(7) of the Code. As Tax Matters Partner, the General Partner shall have the right and obligation to take all actions authorized and required, respectively, by the Code for the Tax Matters Partner. The General Partner shall have the right to retain professional assistance in respect of any audit of the Partnership by the Service and all out-of-pocket expenses and fees incurred by the General Partner on behalf of the Partnership as Tax Matters Partner shall constitute Partnership expenses. In the event the General Partner receives notice of a final Partnership adjustment under Section 6223(a)(2) of the Code, the General Partner shall either (i) file a court petition for judicial review of such final adjustment within the period provided under Section 6226(a) of the Code, a copy of which petition shall be mailed to all Limited Partners on the date such petition is filed, or (ii) mail a written notice to all Limited Partners, within such period, that describes the General Partner's reasons for determining not to file such a petition.

(b) All elections required or permitted to be made by the Partnership under the Code or any applicable state or local tax law shall be made by the General Partner in its sole and absolute discretion.

(c) In the event of a transfer of all or any part of the Partnership Interest of any Partner, the Partnership, at the option and in the sole and absolute discretion of the General Partner, may elect pursuant to Section 754 of the Code to adjust the basis of the Properties. Notwithstanding anything contained in Article 5 of this Agreement, any adjustments made pursuant to Section 754 shall affect only the successor-in-interest to the transferring Partner and in no event shall be taken into account in establishing, maintaining or computing Capital Accounts for the other Partners for any purpose under this Agreement. Each Partner will furnish the Partnership with all information necessary to give effect to such election.

10.6 REPORTS TO LIMITED PARTNERS.

(a) As soon as practicable after the close of each fiscal quarter (other than the last quarter of the fiscal year), the General Partner shall cause to be mailed to each Limited Partner a quarterly report containing financial statements of the Partnership, or of the General Partner if such statements are prepared solely on a consolidated basis with the General Partner, for such fiscal quarter presented in accordance with generally accepted accounting principles. As soon as practicable after the close of each fiscal year, the General Partner shall cause to be mailed to each Limited Partner an annual report containing financial statements of the Partnership, or of the General Partner if such statements are prepared solely on a consolidated basis with the General Partner, for such fiscal year,

presented in accordance with generally accepted accounting principles. The annual financial statements shall be audited by accountants selected by the General Partner.

(b) Any Partner shall further have the right to a private audit of the books and records of the Partnership, provided such audit is made for Partnership purposes and at the expense of the Partner desiring it, and it is made during normal business hours.

ARTICLE 11

AMENDMENT OF AGREEMENT; MEETINGS

11.1 AMENDMENT. The General Partner's consent shall be required for any amendment to this Agreement. The General Partner, without the consent of the Limited Partners, may amend this Agreement in any respect; provided, however,

that the following amendments shall require the consent of Limited Partners holding more than 50% of the Percentage Interests of the Limited Partners:

(a) any amendment affecting the operation of the Conversion Factor or the Exchange Right (except as otherwise provided herein) in a manner adverse to the Limited Partners;

(b) any amendment that would adversely affect the rights of the Limited Partners to receive the distributions payable to them hereunder, other than with respect to the issuance of additional Partnership Units pursuant to Section 4.2 hereof;

(c) any amendment that would alter the Partnership's allocations of Profit and Loss to the Limited Partners, other than with respect to the issuance of additional Partnership Units pursuant to Section 4.2 hereof;

(d) any amendment that would impose on the Limited Partners any obligation to make additional Capital Contributions to the Partnership; or

(e) any amendment to this Article 11.

The foregoing notwithstanding, the approval of any amendment to this Agreement that shall be part of a plan of merger, plan of exchange or plan of conversion involving the Partnership or the Partnership Interests shall be governed by Article XII.

#### 11.2 MEETINGS OF PARTNERS.

(a) The Partners may but shall not be required to hold any annual, periodic or other formal meetings. Meetings of the Partners may be called by the General Partner or by any Limited Partner or Limited Partners holding at least 10% of the Partnership Units in the Partnership.

(b) The Partner or Partners calling the meeting may designate any place within the State of Delaware as the place of meeting for any meeting of the Partners; and Partners holding at least a majority of the Partnership Units in the Partnership may designate any place outside the State of Delaware as the place of meeting for any meeting of the Partners. If no designation is made, or if a special meeting is called, the place of meeting shall be the principal place of business of the Partnership.

(c) Except as provided in Section 11.2(d), written notice stating the place, day and hour of the meeting and the purpose or purposes for which the meeting is called shall be delivered not less than ten (10) nor more than ninety (90) days before the date of the meeting, either personally or by mail, by or at the direction of the Partner or Partners calling the meeting, to each Partner entitled to vote at such meeting and to each Partner not entitled to vote who is entitled to notice of the meeting.

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(d) Anything in this Agreement to the contrary notwithstanding, with respect to any meeting of the Partners, any Partner who in person or by proxy shall have waived in writing notice of the meeting, either before or after such meeting, or who shall attend the meeting in person or by proxy, shall be deemed to have waived notice of such meeting unless such Partner attends for the express purpose of objecting, at the beginning of the meeting, and does so object to the transaction of any business because the meeting is not lawfully called or convened.

(e) If all of the Partners shall meet at any time and place, either within or outside of the State of Delaware, in person or by proxy, and consent to the holding of a meeting at such time and place, such meeting shall be valid without call or notice, and at such meeting lawful action may be taken.

(f) For the purpose of determining Partners entitled to notice of or to vote at any meeting of Partners or any adjournment thereof, the date on which notice of the meeting is mailed shall be the record date. When a determination of Partners entitled to vote at any meeting of Partners has been made as provided in this Section, such determination shall apply to any adjournment thereof.

(g) Partners holding at least a majority of the Partnership Units entitled to vote at a meeting, represented in person or by proxy, shall constitute a quorum at any meeting of Partners. In the absence of a quorum at any such meeting, Partners holding at least a majority of Partnership Units so represented may adjourn the meeting to another time and place. Any business which might have been transacted at the original meeting may be transacted at any adjourned meeting at which a quorum is present. No notice of an adjourned meeting need be given if the time and place are announced at the meeting at which the adjournment is taken unless the adjournment is for more than 120 days.

The Partners present at a duly organized meeting may continue to transact business until adjournment, notwithstanding the withdrawal during such meeting of that number Partnership Units whose absence would cause less than a quorum to be present.

(h) If a quorum is present, the affirmative vote of Partners holding a majority of the Partnership Units entitled to vote, present in person or represented by proxy, shall be binding on all Partners, unless the vote of a greater or lesser proportion or number of Partnership Units or Partners is otherwise required by applicable law or by this Agreement. Unless otherwise expressly provided herein or required under applicable law, Partners who have an interest (economic or otherwise) in the outcome of any particular matter upon which the Partners' vote or consent is required may vote or consent upon any such matter and their Partnership Units, vote or consent, as the case may be, shall be counted in the determination of whether the requisite matter was approved by the Partners.

(i) At all meetings of Partners, a Partner may vote in person or by proxy executed in writing by the Partner or by the Partner's duly authorized attorney-in-fact. Such proxy shall be filed with the General Partner before or at the time of the meeting. No proxy shall be valid after eleven months from the date of its execution, unless otherwise provided in the proxy.

(j) Action required or permitted to be taken at a meeting of Partners may be taken without a meeting if the action is evidenced by one or more written consents or approvals describing the action taken and signed by sufficient Partners or Partners holding sufficient Partnership Units, as the case may be, to approve such action had such action been properly voted on at a duly called meeting of the Partners. Action taken under this Section 11.2(j) is effective when the requisite Partners or Partners with the requisite Partnership Units, as the case may be, have signed the consent or approval, unless the consent specifies a different effective date.

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## ARTICLE 12

### MERGER, EXCHANGE OR CONVERSION

#### 12.1 MERGER, EXCHANGE OR CONVERSION OF PARTNERSHIP.

(a) The Partnership may (i) adopt a plan of merger and may merge with or into one or more domestic or foreign limited partnerships or other entities with the resulting entity being one or more surviving entities, (ii) adopt a plan of exchange by which a domestic or foreign limited partnership or other entity is to acquire all of the outstanding Partnership Interests of the Partnership in exchange for cash, securities or other property of the acquiring domestic or foreign limited partnership or other entity or (iii) adopt a plan of conversion and convert to a foreign limited partnership or other entity. Any such plan of merger, plan of exchange, or plan of conversion shall otherwise comply with the requirements of this Agreement and the Act.

(b) Any merger pursuant to a plan of merger described in Section 12.1(a)(i) hereof shall be conditioned upon the merger being permitted by the laws under which each other entity that is a party to the merger is incorporated or organized or by the constituent documents of such other entity that are not inconsistent with such laws. Any exchange pursuant to a plan of exchange described in Section 12.1(a)(ii) hereof shall be conditioned upon the issuance of shares or other interests of the acquiring foreign limited partnership or other entity being permitted by the laws under which such foreign limited partnership or other entity is incorporated or organized or is not inconsistent with such laws. Any conversion pursuant to a plan of conversion described in Section 12.1(a)(iii) hereof shall be conditioned upon such conversion being permitted by, or not inconsistent with, the laws of the jurisdiction in which the converted entity is to be incorporated, formed or organized and the incorporation, formation or organization of the converted entity is effected in compliance with such laws.

(c) The Partnership may adopt a plan of merger, plan of exchange or plan of conversion if the General Partner acts upon and the Limited Partners (if required by Section 12.2 below) approve the plan of merger, plan of exchange or plan of conversion in the manner prescribed in Section 12.2 below.

#### 12.2 APPROVAL OF PLAN OF MERGER, EXCHANGE OR CONVERSION.

(a) Except as provided by Section 12.2(g) below, after acting on a plan of merger, plan of exchange or plan of conversion in the manner prescribed by Section 12.2(b)(i), the General Partner shall submit the plan of merger, plan of exchange or plan of conversion for approval by the Limited Partners.

(b) Except as provided by Section 12.2(f) below, for a plan of merger, plan of exchange or plan of conversion to be approved:

(i) the General Partner shall adopt a resolution recommending that the plan of merger, plan of exchange or plan of conversion be approved by the Limited Partners, unless the General Partner determines that for any reason it should not make that recommendation, in which case the General Partner shall adopt a resolution directing that the plan of merger, plan of exchange or plan of conversion be submitted to the Limited Partners for approval without recommendation; and

(ii) the Limited Partners entitled to vote on the plan of merger, plan of exchange or plan of conversion must approve the plan.

(c) The General Partner may condition its submission to the Limited Partners of a plan of merger, plan of exchange or plan of conversion, and the effectiveness of such plan, on any basis, including without limitation that a specified percentage of the Percentage Interests of the Limited Partners in excess of a majority of the Percentage Interests of the Limited Partners be required for the approval of the plan of merger, plan of exchange or plan of conversion.

(d) The General Partner shall notify each Limited Partner, whether or not entitled to vote, of the meeting of the Limited Partners at which the plan of merger, plan of exchange or plan of conversion is to be submitted for approval in accordance with this Section 12.2 and applicable law. The notice shall be given at least twenty (20) days before the meeting and shall state that the purpose, or one of the purposes, of the meeting is to consider the plan of merger, plan of exchange or plan of conversion and shall contain or be accompanied by a copy or summary of the plan. Any such approval may be by written consent of the requisite Limited Partners as would be required to approve the plan at any meeting where all the Limited Partners are present.

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(e) Unless the General Partner (acting pursuant to Section 12.2(c)) requires a greater vote, the vote of the Limited Partners required for approval of a plan of merger, plan of exchange or plan of conversion shall be the affirmative vote of the holders of more than 50% of the Percentage Interests of the Limited Partners entitled to vote thereon.

(f) Unless applicable law otherwise requires (in which case the approval of the Limited Partners shall continue to be required and the foregoing provisions of this Section 12.2 shall continue to apply), (1) approval by the Limited Partners on a plan of exchange shall not be required, and the foregoing provisions of this Section 12.2 do not apply, if the Partnership is the acquiring entity in the plan of exchange, and (2) approval by the Limited Partners on a plan of merger or a plan of conversion shall not be required and the foregoing provisions of this Section 12.2 do not apply, if:

(i) a limited partnership is the sole surviving or resulting entity;

(ii) the partnership agreement of the surviving or resulting limited partnership will not materially differ from this Agreement before the merger or conversion in any manner other than as to applicable law or other insignificant conforming differences;

(iii) Limited Partners who held Limited Partnership Interests immediately before the effective date of the merger or conversion will hold interests in the surviving or resulting entity in the same proportions, immediately after the effective date of the merger or conversion; and

(iv) the General Partner adopts a resolution approving the plan of merger or plan of conversion.

(g) After a plan of merger, plan of exchange or plan of conversion is approved, and at any time before the merger, exchange or conversion has become effective, the plan of merger, plan of exchange or plan of conversion may be abandoned (subject to any contractual rights by any of the entities that are a party thereto), without action by the Limited Partners, in accordance with the procedures set forth in the plan of merger, plan of exchange or plan of conversion or, if no such procedures are set forth in the plan, in the manner determined by the General Partner.

#### 12.3 RIGHTS OF DISSENTING LIMITED PARTNERS.

(a) In the absence of fraud in the transaction, the remedy provided by this Section 12.3 to a Limited Partner voting against any merger, exchange or conversion or objecting to a merger, exchange or conversion approved by the written consent of Limited Partners (a "DISSENTING LIMITED PARTNER") is



the exclusive remedy for the recovery of the value of his Limited Partnership interests or money damages with respect to the transaction. If the existing, surviving, or new corporation or limited partnership (foreign or domestic) or other entity, as the case may be, complies with the requirements of this Section 12.3, any Dissenting Limited Partner who fails to comply with the requirements of this Section 12.3 shall not be entitled to bring suit for the recovery of the value of his Limited Partnership interests or money damages with respect to the transaction. A "Dissenting Limited Partner" in respect of any merger, exchange or conversion shall expressly exclude any Limited Partner who votes in favor of the related plan of merger, plan of exchange or plan of conversion or who abstains or fails to timely vote therefor. In the event of a plan of merger, plan of exchange or plan of conversion approved by written consent, a "Dissenting Limited Partner" in respect of any related merger, exchange or conversion shall expressly exclude Limited Partners who provide such written consent and Limited Partners who fail to object to the merger, exchange or conversion and demands payment for such Limited Partner's Limited Partnership Interest in writing to the General Partner within twenty (20) days after notice to the Limited Partners of the receipt by the Partnership of written consents sufficient to approve such merger, exchange or conversion. All such Limited Partners who are not included within the definition of Dissenting Limited Partner in respect of any merger, exchange or conversion shall participate in the merger, exchange or conversion according to the approved plan of merger, plan of exchange or plan of conversion.

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(b) Any Dissenting Limited Partner who has opted for payment for his Limited Partnership interests shall not thereafter be entitled to vote or exercise any other rights of a Limited Partner except the right to receive payment for his Limited Partnership interests and the right to maintain an appropriate action to obtain relief on the ground that the transaction would be or was fraudulent. Limited Partnership Interests of Dissenting Limited Partners for which payment has been made shall not thereafter be considered outstanding for the purposes of any subsequent vote of the Limited Partners.

(c) Within twenty (20) days after a Dissenting Limited Partner votes against any plan of merger, plan of exchange or plan of conversion which is approved by a vote of the Limited Partners, or in connection with a Limited Partner's objection to any plan of merger, plan of exchange or plan of conversion approved by the written consent of the Limited Partners, the Dissenting Limited Partner may demand by written notice to the General Partner that payment for his Limited Partnership Interest be made. Upon receipt of such a payment demand, the General Partner shall (i) make a notation on the records of the Partnership that such demand has been made and (ii) within a reasonable period of time after the later of the receipt of a payment demand or the consummation of the merger, exchange or conversion, cause the Partnership to pay to the Dissenting Limited Partner the fair value of such Dissenting Limited Partner's Partnership Interest without interest. The fair value of a Dissenting Limited Partner's Partnership Interest shall be an amount equal to the Dissenting Limited Partner's pro rata share (as would be determined under Section 5.6 hereof if the Partnership were liquidating) of the appraised value of the net assets of the Partnership based on an appraisal of all assets of the Partnership from a Competent Independent Expert. The assets of the Partnership shall be appraised on a consistent basis. The appraisal shall be based on an evaluation of all relevant information and shall include the current value of the Partnership's assets as of the date immediately prior to the proposed merger, exchange or conversion. The appraisal shall assume an orderly liquidation of the Partnership's assets over a twelve (12) month period, shall consider other balance sheet items, and shall be net of the assumed cost of sale. The terms of the engagement of the appraiser shall clearly state that the engagement is for the benefit of the Partnership and its Limited Partners. A summary of the independent appraisal, including all material assumptions underlying the appraisal, shall be provided to Dissenting Limited Partners in connection with the payment of the fair value of their Limited Partnership Interests.

(d) If a Dissenting Limited Partner shall fail to make a payment demand within the period provided in Section 12.3(c) hereof or, in respect of a plan of merger, plan of exchange or plan of conversion approved by written consent of the Limited Partners, shall fail to provide notice of dissent within the period set forth in Section 12.3(a) hereof, such Dissenting Limited Partner and all persons claiming under him shall be conclusively presumed to have approved and ratified the merger, conversion or exchange and shall be bound thereby, the right of such Dissenting Limited Partner to be paid the fair value of his Limited Partnership Interest shall cease, and his status as a Limited Partner shall be restored without prejudice to any proceedings which may have been taken during the interim, and such Dissenting Limited Partner shall be entitled to receive any distributions made to Limited Partners in the interim.

## GENERAL PROVISIONS

13.1 NOTICES. All communications required or permitted under this Agreement shall be in writing and shall be deemed to have been given when delivered personally or upon deposit in the United States mail, registered, postage prepaid return receipt requested, to the Partners at the addresses set forth in Exhibit A attached hereto; provided, however, that any Partner may specify a different address by notifying the General Partner in writing of such different address. Notices to the Partnership shall be delivered at or mailed to its specified office.

13.2 SURVIVAL OF RIGHTS. Subject to the provisions hereof limiting transfers, this Agreement shall be binding upon and inure to the benefit of the Partners and the Partnership and their respective legal representatives, successors, transferees and assigns.

13.3 ADDITIONAL DOCUMENTS. Each Partner agrees to perform all further acts and execute, swear to, acknowledge and deliver all further documents which may be reasonable, necessary, appropriate or desirable to carry out the provisions of this Agreement or the Act.

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13.4 SEVERABILITY. If any provision of this Agreement shall be declared illegal, invalid, or unenforceable in any jurisdiction, then such provision shall be deemed to be severable from this Agreement (to the extent permitted by law) and in any event such illegality, invalidity or unenforceability shall not affect the remainder hereof.

13.5 ENTIRE AGREEMENT. This Agreement and exhibits attached hereto constitute the entire Agreement of the Partners and supersede all prior written agreements and prior and contemporaneous oral agreements, understandings and negotiations with respect to the subject matter hereof, except as otherwise set forth herein.

13.6 PRONOUNS AND PLURALS. When the context in which words are used in the Agreement indicates that such is the intent, words in the singular number shall include the plural and the masculine gender shall include the neuter or female gender as the context may require.

13.7 HEADINGS. The Article and Section headings in this Agreement are for convenience only and shall not be used in construing the scope of this Agreement or any particular Article or Section hereof.

13.8 COUNTERPARTS. This Agreement may be executed in several counterparts, each of which shall be deemed to be an original copy and all of which together shall constitute one and the same instrument binding on all parties hereto, notwithstanding that all parties shall not have signed the same counterpart.

### 13.9 GOVERNING LAW; VENUE.

(a) This Agreement shall be governed by, and interpreted and construed in accordance with, the internal laws of the State of Delaware (without regard to its conflicts of law principles); provided, however, that any cause of action for violation of federal or state securities law shall not be governed by this Section 13.9(a).

(b) Venue for the adjudication of any claim or dispute arising out of this Agreement shall be proper only in the state or federal courts resident in the federal Eastern District of the Commonwealth of Virginia, and all parties to this Agreement hereby consent to such venue and agree that it shall not be inconvenient and not subject to review by any court other than such courts in Virginia.

(c) The parties hereto intend and agree that the courts of the jurisdictions in which any Partner is formed and in which any Partner conducts its business should afford full faith and credit to any judgment rendered by a court of the Commonwealth of Virginia against such Partner or any other Partner, under this Agreement, and the parties hereto each intend and agree that such courts should hold that the Virginia courts have jurisdiction to enter a valid, in personam judgment against each Partner.

(d) The parties hereto agree that service of any summons and complaint, and other process which may be served in any suit, action or other proceeding, may be made by mailing via U.S. certified or registered mail or by hand-delivering a copy of such process to the Partner at its address set forth in Exhibit A or as otherwise specified pursuant to Section 13.1.

### 13.10 ACKNOWLEDGEMENT AS TO EXCULPATION AND INDEMNIFICATION. THE

PARTIES HERETO ACKNOWLEDGE AND AGREE THAT THIS AGREEMENT CONTAINS EXCULPATION AND INDEMNIFICATION IN RESPECT OF THE ACTIONS OR OMISSIONS OF THE GENERAL PARTNER AND DIRECTORS, OFFICERS AND AFFILIATES OF THE GENERAL PARTNER BY THE PARTNERSHIP EVEN IF SUCH ACTIONS OR OMISSIONS CONSTITUTE NEGLIGENCE OF SUCH PERSONS.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties hereto have hereunder affixed their signatures to this Agreement of Limited Partnership of Gladstone Commercial Limited Partnership as of the 17th day of July, 2003.

GENERAL PARTNER:

GLADSTONE COMMERCIAL CORPORATION

By: /s/ David Gladstone  
-----  
Name: David Gladstone  
Title: Chairman and Chief Executive Officer

ORIGINAL LIMITED PARTNER:

GLADSTONE COMMERCIAL PARTNERS, LLC

By: /s/ David Gladstone  
-----  
Name: David Gladstone  
Title: Managing Member

INDEX OF EXHIBITS

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EXHIBIT A

PARTNERS, CAPITAL CONTRIBUTIONS AND PARTNERSHIP UNITS

As of July 17, 2003

<Table>  
<Caption>

Partners	Cash Contribution	Agreed Value of Property Contribution	Partnership Units
Percentage Interest			
-----	-----	-----	-----
<S>	<C>	<C>	<C>

GENERAL PARTNER: \$ \_\_\_\_\_ N/A \_\_\_\_\_ Units  
\_\_\_\_\_ %

Gladstone Commercial Corporation  
1750 Tysons Blvd.  
Fourth Floor  
McLean, Virginia 22102

ORIGINAL LIMITED PARTNER:  
Gladstone Commercial Partners, LLC  
1750 Tysons Blvd.  
Fourth Floor  
McLean, Virginia 22102 \$ \_\_\_\_\_ N/A \_\_\_\_\_ Units  
\_\_\_\_\_ %

ADDITIONAL LIMITED PARTNERS: [none]  
</Table>

EXHIBIT B

NOTICE OF EXERCISE OF EXCHANGE RIGHT

In accordance with Section 8.5 the Agreement of Limited Partnership of Gladstone Commercial Limited Partnership, as amended (the "AGREEMENT"), the undersigned hereby irrevocably (i) presents for exchange \_\_\_\_\_ Partnership Units in Gladstone Commercial Limited Partnership in accordance with the terms of the Agreement and the Exchange Right referred to therein; (ii) surrenders such Partnership Units and all right, title and interest therein; and (iii) directs that the Cash Amount or REIT Shares Amount (as defined in the Agreement) as determined by the General Partner deliverable upon exercise of the Exchange Right be delivered to the address specified below, and if REIT Shares (as defined in the Agreement) are to be delivered, such REIT Shares be registered or placed in the name(s) and at the address(es) specified below.

Dated: \_\_\_\_\_

\_\_\_\_\_  
(Signature of Limited Partner)

\_\_\_\_\_  
(Printed Name of Limited Partner)

Mailing Address and Phone No.:  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

( )  
\_\_\_\_\_  
\_\_\_\_\_

If REIT Shares are to be issued, issue to:

Name: \_\_\_\_\_

Mailing Address and Phone No.:  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

( )  
\_\_\_\_\_  
\_\_\_\_\_

Social security or other tax identification number: \_\_\_\_\_

For Exchanging Partners that are entities:

CERTIFICATION OF NON-FOREIGN STATUS

Under Section 1445(e) of the Internal Revenue Code of 1986, as amended (the "Code"), in the event of a disposition by a non-U.S. person of a partnership interest in a partnership in which (i) 50% or more of the value of the gross assets consists of United States real property interests ("USRPIs"), as defined in section 897(c) of the Code, and (ii) 90% or more of the value of the gross assets consists of USRPIs, cash, and cash equivalents, the transferee will be required to withhold 10% of the amount realized by the non-U.S. person upon the disposition. To inform Gladstone Commercial Corporation (the "General Partner") and Gladstone Commercial Limited Partnership (the "Partnership") that no withholding is required with respect to the redemption by \_\_\_\_\_ ("Partner") of its units of limited partnership interest in the Partnership, the undersigned hereby certifies the following on behalf of Partner:

- 1. Partner is not a foreign corporation, foreign partnership, foreign trust, or foreign estate, as those terms are defined in the Code and the Treasury regulations thereunder.
- 2. The U.S. employer identification number of Partner is \_\_\_\_\_.
- 3. The principal business address of Partner is: \_\_\_\_\_ and Partner's place of incorporation is \_\_\_\_\_.
- 4. Partner agrees to inform the Company if it becomes a foreign person at any time during the three-year period immediately following the date of this notice.
- 5. Partner understands that this certification may be disclosed to the Internal Revenue Service by the General Partner and that any false statement contained herein could be punished by fine, imprisonment, or both.

PARTNER:

-----  
(entity name)

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

Under penalties of perjury, I declare that I have examined this certification and, to the best of my knowledge and belief, it is true, correct, and complete, and I further declare that I have authority to sign this document on behalf of Partner.

Date: \_\_\_\_\_ Name: \_\_\_\_\_  
Title: \_\_\_\_\_

For Exchanging Partners that are individuals:

CERTIFICATION OF NON-FOREIGN STATUS

Under Section 1445(e) of the Internal Revenue Code of 1986, as amended (the "Code"), in the event of a disposition by a non-U.S. person of a partnership interest in a partnership in which (i) 50% or more of the value of the gross assets consists of United States real property interests ("USRPIs"), as defined in section 897(c) of the Code, and (ii) 90% or more of the value of the gross assets consists of USRPIs, cash, and cash equivalents, the transferee will be required to withhold 10% of the amount realized by the non-U.S. person upon the disposition. To inform Gladstone Commercial Corporation (the "General Partner") and Gladstone Commercial Limited Partnership (the "Partnership") that no withholding is required with respect to my redemption of my units of limited partnership interest in the Partnership, I, \_\_\_\_\_, hereby certify the following:

- 1. I am not a nonresident alien for purposes of U.S. income taxation.

2. My U.S. taxpayer identification number (social security number) is

\_\_\_\_\_.

3. My home address is: \_\_\_\_\_.

4. I agree to inform the General Partner promptly if I become a nonresident alien at any time during the three-year period immediately following the date of this notice.

5. I understand that this certification may be disclosed to the Internal Revenue Service by the General Partner and that any false statement contained herein could be punished by fine, imprisonment, or both.

Name: \_\_\_\_\_

Under penalties of perjury, I declare that I have examined this certification and, to the best of my knowledge and belief, it is true, correct, and complete.

Date: \_\_\_\_\_

Name: \_\_\_\_\_

Subsidiaries

Gladstone Commercial Partners, LLC -- Delaware

Gladstone Commercial Limited Partnership -- Delaware

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the use in this Pre-Effective Amendment No. 1 to the Registration Statement on Form S-11 of our report dated July 18, 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 headings "Experts".

/s/ PricewaterhouseCoopers LLP

New York, NY  
July 21, 2003



MAURICE "BUZZ" COULON

June 14, 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. 333-106024, 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/ Maurice Coulon

Maurice "Buzz" Coulon