
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTER ENDED JUNE 30, 2004

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

COMMISSION FILE NUMBER: 0-50363

GLADSTONE COMMERCIAL CORPORATION

(Exact name of registrant as specified in its charter)

MARYLAND
(State or other jurisdiction of incorporation or
organization)

02-0681276
(I.R.S. Employer Identification No.)

1616 ANDERSON ROAD, SUITE 208
MCLEAN, VIRGINIA 22102
(Address of principal executive office)

(703) 286-7000
(Registrant's telephone number, including area code)

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. The number of shares of the issuer's Common Stock, \$0.001 par value, outstanding as of August 4, 2004 was 7,642,000.

GLADSTONE COMMERCIAL CORPORATION
TABLE OF CONTENTS

PART I	FINANCIAL INFORMATION
Item 1	Consolidated Financial Statements (Unaudited)
	Consolidated Balance Sheets as of June 30, 2004 and December 31, 2003
	Consolidated Statement of Operations for the three and six months ended June 30, 2004 and the three months ended June 30, 2003 and for the period February 14, 2003 (inception) through June 30, 2003
	Consolidated Statement of Cash Flows for the six months ended June 30, 2004 and for the period February 14, 2003 (inception) through June 30, 2003
	Notes to Financial Statements
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations
	Overview
	Results of Operations
	Liquidity and Capital Resources
Item 3	Quantitative and Qualitative Disclosure About Market Risk
Item 4	Controls and Procedures
PART II	OTHER INFORMATION
Item 1	Legal Proceedings
Item 2	Changes in Securities and Use of Proceeds
Item 3	Defaults Upon Senior Securities
Item 4	Submission of Matters to a Vote of Security Holders
Item 5	Other Information
Item 6	Exhibits and Reports on Form 8-K
Signatures	

PART I – FINANCIAL INFORMATION

Gladstone Commercial Corporation

Item 1 - Consolidated Financial Statements

(Unaudited)

June 30, 2004

CONTENTS

Consolidated Balance Sheets

Consolidated Statements of Operations

Consolidated Statement of Cash Flows

Notes to Financial Statements

GLADSTONE COMMERCIAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	<u>June 30, 2004</u>	<u>December 31, 2003</u>
ASSETS		
Real estate, net	\$ 26,863,418	\$ 5,436,153
Mortgage note receivable	11,150,787	—
Cash and cash equivalents	65,016,018	99,075,765
Funds held in escrow	187,234	—
Interest receivable – mortgage note	61,950	—
Deferred rent receivable	41,535	—
Prepaid expenses	68,932	191,432
Other assets	25,000	—
Lease intangibles, net of accumulated amortization of \$38,979 and \$1,208, respectively	989,831	358,020
TOTAL ASSETS	<u>\$104,404,705</u>	<u>\$105,061,370</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Due to Adviser	\$ 103,210	\$ 234,295
Accounts payable	41,594	—
Dividends payable	917,040	76,420
Accrued expenses	14,220	—
Rent received in advance, security deposits and funds held in escrow	480,826	—
Total Liabilities	<u>\$ 1,556,890</u>	<u>\$ 310,715</u>
STOCKHOLDERS' EQUITY		
Common stock, \$0.001 par value, 20,000,000 shares authorized and 7,642,000 shares issued and outstanding	\$ 7,642	\$ 7,642
Additional paid in capital	105,052,573	105,060,304
Distributions in excess of accumulated earnings	(2,212,400)	(317,291)
Total Stockholders' Equity	<u>\$102,847,815</u>	<u>\$104,750,655</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$104,404,705</u>	<u>\$105,061,370</u>

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

GLADSTONE COMMERCIAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	For the three months ended June 30, 2004	For the three months ended June 30, 2003	For the six months ended June 30, 2004	For the period February 14, 2003 (inception) through June 30, 2003
OPERATING REVENUES				
Rental income	\$ 403,690	\$ —	\$ 601,463	\$ —
Interest income from mortgage note receivable	278,980	—	412,400	—
Total operating revenues	<u>682,670</u>	<u>—</u>	<u>1,013,863</u>	<u>—</u>
OPERATING EXPENSES				
Management advisory fee	280,122	—	509,538	—
Depreciation and amortization	126,772	—	206,101	—
General and administrative	306,024	105	694,238	10,654
Total operating expenses	<u>712,918</u>	<u>105</u>	<u>1,409,877</u>	<u>10,654</u>
Net loss from operations	<u>(30,248)</u>	<u>(105)</u>	<u>(396,014)</u>	<u>(10,654)</u>
Interest income from temporary investments	162,523	—	334,985	—
NET INCOME (LOSS)	<u>\$ 132,275</u>	<u>\$ (105)</u>	<u>\$ (61,029)</u>	<u>\$ (10,654)</u>
Earnings (loss) per weighted average common share				
Basic	<u>\$ 0.02</u>	<u>\$ (0.00)</u>	<u>\$ (0.01)</u>	<u>\$ (0.20)</u>
Diluted	<u>\$ 0.02</u>	<u>\$ (0.00)</u>	<u>\$ (0.01)</u>	<u>\$ (0.20)</u>
Weighted average shares outstanding				
Basic	<u>7,642,000</u>	<u>52,000</u>	<u>7,642,000</u>	<u>52,000</u>
Diluted	<u>7,695,134</u>	<u>52,000</u>	<u>7,764,732</u>	<u>52,000</u>

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

GLADSTONE COMMERCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the six months ended June 30, 2004	For the period February 14, 2003 (inception) through June 30, 2003
Cash flows from operating activities:		
Net loss	\$ (61,029)	\$ (10,654)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	206,101	—
Changes in assets and liabilities:		
Increase in mortgage interest receivable	(61,950)	—
Decrease in prepaid expenses	122,500	—
Increase in other assets	(25,000)	—
Increase in deferred rent receivable	(41,535)	—
Increase in accounts payable	41,594	10,654
Decrease in due to Adviser	(131,085)	—
Increase in accrued expenses	14,220	—
Increase in rent received in advance and security deposits	293,592	—
Net cash provided by operating activities	<u>357,408</u>	<u>—</u>
Cash flows from investing activities:		
Acquisition of real estate	(22,265,178)	—
Mortgage note receivable	(11,170,000)	—
Principal repayments on mortgage note receivable	19,213	—
Net cash used in investing activities	<u>(33,415,965)</u>	<u>—</u>
Cash flows from financing activities:		
Proceeds from share issuance	—	52,000
Payments for deferred offering costs	—	(22,385)
Offering costs	(7,730)	—
Dividends paid	(993,460)	—
Net cash (used in) provided by financing activities	<u>(1,001,190)</u>	<u>29,615</u>
Net (decrease) increase in cash and cash equivalents	<u>(34,059,747)</u>	<u>29,615</u>
Cash and cash equivalents, beginning of period	99,075,765	—
Cash and cash equivalents, end of period	<u>\$ 65,016,018</u>	<u>\$ 29,615</u>

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

GLADSTONE COMMERCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization

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

On February 15, 2003, the Company's initial stockholder purchased 52,000 shares of common stock (the "Shares") for \$52,000 and was admitted as the initial stockholder of the Company.

On August 18, 2003, the Company closed its initial public offering (the "Offering") and sold 6,600,000 shares of its common stock and on September 17, 2003, the underwriters purchased an additional 990,000 shares of common stock, both sales at \$15.00 per share less an underwriting discount of \$1.05 per share, offering costs were \$699,352 for total net proceeds to the Company of \$105,015,946.

2. Summary of Significant Accounting Policies

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

Interim financial information

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

Investments in real estate

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

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

The Company allocates purchase price to the fair value of the tangible assets of an acquired property (which includes the land, building, and tenant improvements) to be determined by valuing the property as if

it were vacant. The “as-if-vacant” value is allocated to land, building, and tenant improvements based on management’s determination of the relative fair values of these assets.

Above-market and below-market in-place lease values for owned properties are recorded based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management’s estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. The capitalized above-market lease values will be amortized as a reduction of rental income over the remaining non-cancelable terms of the respective leases. The capitalized below-market lease values (presented in the accompanying balance sheet as value of assumed lease obligations) are amortized as an increase to rental income over the initial term and any fixed-rate renewal periods in the respective leases. Since the Company’s strategy to a large degree involves sale-leaseback transactions with newly originated leases at market rates, the above-market and below-market in-place lease values are not significant for many of the transactions that the Company enters into.

The aggregate value of other intangible assets acquired are measured based on the difference between (i) the property valued with existing in-place leases adjusted to market rental rates and (ii) the property valued as if vacant. Management’s estimates of value are made using methods similar to those used by independent appraisers (e.g., discounted cash flow analysis). Factors considered by management in its analysis include an estimate of carrying costs during hypothetical expected lease-up periods considering current market conditions, and costs to execute similar leases. The Company also considers information obtained about each property as a result of its pre-acquisition due diligence, marketing and leasing activities in estimating the fair value of the tangible and intangible assets acquired. In estimating carrying costs, management also includes real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, which primarily range from six to 18 months, depending on specific local market conditions. Management also estimates costs to execute similar leases including leasing commissions, legal and other related expenses to the extent that such costs are not already incurred in connection with a new lease origination as part of the transaction.

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

The value of in-place leases is amortized to expense over the initial term of the respective leases, which range from six to 20 years. The value of customer relationship intangibles are amortized to expense over the initial term and any renewal periods in the respective leases, but in no event does the amortization period for intangible assets exceed the remaining depreciable life of the building. Should a tenant terminate its lease, the unamortized portion of the in-place lease value and customer relationship intangibles will be charged to expense. Total amortization expense was \$24,184 and \$37,771 for the three and six months ended June 30, 2004, respectively.

Impairment

Investments in Real Estate

The Company periodically reviews the carrying value of each property to determine if circumstances that indicate impairment in the carrying value of the investment exist or that depreciation periods should be modified. If circumstances support the possibility of impairment, the Company will prepare a projection of the undiscounted future cash flows, without interest charges, of the specific property and determine if the investment in such property is recoverable. If impairment is indicated, the carrying value of the property is written down to its estimated fair value based on the Company’s best estimate of the property’s discounted

future cash flows. There have been no impairments recognized on the Company's real estate assets at June 30, 2004.

Provision for Loan Losses

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

Cash and cash equivalents

The Company considers all short-term, highly liquid investments that are both readily convertible to cash and have a maturity of generally three months or less at the time of purchase to be cash equivalents; except that any such investments purchased with funds on deposit in escrow or similar accounts are classified as restricted deposits. Items classified as cash equivalents include commercial paper and money-market funds. All of the Company's cash and cash equivalents at June 30, 2004 were held in the custody of one financial institution, and which balance at times may exceed federally insurable limits. The Company mitigates this risk by depositing funds with major financial institutions.

Organizational costs

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

Stock based compensation

In December 2002, the Financial Accounting Standards Board ("FASB") approved the issuance of Statement of Financial Accounting Standards ("SFAS") No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure." The statement amended SFAS No. 123 "Accounting for Stock-Based Compensation" to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock based employee compensation. Furthermore, SFAS No. 148 amended the disclosure requirements of SFAS No. 123 to require more prominent disclosures in both annual and interim financial statements about the method and related effect on results of accounting for stock-based employee compensation, effective for fiscal year and interim periods beginning after December 15, 2002.

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

Income taxes

The Company has and will operate in a manner that will allow it to qualify as a real estate investment trust under the Internal Revenue Code of 1986, and accordingly will not be subject to Federal income taxes on amounts distributed to stockholders (except income from foreclosure property), provided it distributes at least 90% of its real estate investment trust taxable income to its stockholders and meets certain other conditions.

Revenue recognition

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

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

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.

Segment information

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" provides standards for public companies relating to the reporting of financial and descriptive information about their operating segments in financial statements. Operating segments are defined as components of an enterprise for which separate financial information is available and is evaluated regularly by the chief operating decision maker or decision making group in determining how to allocate resources and in assessing performance. Company management is the chief decision making group.

As of June 30, 2004, the Company's operations are derived from two operating segments. One segment purchases real estate (land, buildings and other improvements), which are simultaneously leased to existing users and the other segment extends mortgage loans and collects principal and interest payments. For the three and six months ended June 30, 2003, there was no activity relating to segments because the Company had only recently begun operations. The following tables summarize the Company's operating results by segment for the three and six months ended June 30, 2004:

Three Months Ended June 30, 2004

	Real Estate Leasing	Real Estate Lending	Other	Total
Revenue	\$ 403,690	\$ 278,980	\$ —	\$ 682,670
Expenses	<u>126,772</u>	<u>—</u>	<u>586,146</u>	<u>712,918</u>
Income (loss) from operations	<u>276,918</u>	<u>278,980</u>	<u>(586,146)</u>	<u>(30,248)</u>
Other income	<u>—</u>	<u>—</u>	<u>162,523</u>	<u>162,523</u>
Net income (loss)	<u>\$ 276,918</u>	<u>\$ 278,980</u>	<u>\$ (423,623)</u>	<u>\$ 132,275</u>
Total Assets	<u>\$27,894,784</u>	<u>\$11,399,971</u>	<u>\$65,109,950</u>	<u>\$104,404,705</u>

Six Months Ended June 30, 2004

	Real Estate Leasing	Real Estate Lending	Other	Total
Revenue	\$ 601,463	\$ 412,400	\$ —	\$ 1,013,863
Expenses	<u>206,101</u>	<u>—</u>	<u>1,203,776</u>	<u>1,409,877</u>
Income (loss) from operations	<u>395,362</u>	<u>412,400</u>	<u>(1,203,776)</u>	<u>(396,014)</u>
Other income	<u>—</u>	<u>—</u>	<u>334,985</u>	<u>334,985</u>
Net income (loss)	<u>\$ 395,362</u>	<u>\$ 412,400</u>	<u>\$ (868,791)</u>	<u>\$ (61,029)</u>
Total Assets	<u>\$27,894,784</u>	<u>\$11,399,971</u>	<u>\$65,109,950</u>	<u>\$104,404,705</u>

3. Management Advisory Fee

The Company has entered into an agreement with the Company's Adviser in which the Adviser will be responsible for managing the Company on a day-to-day basis and for identifying, evaluating, negotiating and consummating investment transactions consistent with the Company's criteria. In exchange for such services, the Company will reimburse the Adviser for certain expenses. The Company has no employees, and all operations are managed by the Company's Adviser subject to a management advisory agreement. The Company will reimburse the Adviser for its pro-rata share of the payroll and related benefit expenses on an employee-by-employee basis, based on the percentage of each employee's time devoted to Company matters. The Company will also reimburse the Adviser for general overhead expenses multiplied by the ratio of hours worked by Adviser employees on Company matters to the total hours worked by Adviser employees. For the three and six months ended June 30, 2004, the Company has incurred approximately \$280,000 and \$510,000, respectively, in management advisory fees. Approximately \$103,000 was unpaid at June 30, 2004. There were no fees incurred for the three months ended June 30, 2003 and for the period February 14, 2003 (inception) through June 30, 2004.

4. Stock Options

In December 2002, the FASB approved the issuance of SFAS No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure." The statement amended SFAS No. 123 "Accounting for Stock-Based Compensation" to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock based employee compensation. Furthermore, SFAS No. 148 amended the disclosure requirements of SFAS No. 123 to require more prominent disclosures in both annual and interim financial statements about the method and related effect on results of accounting for stock-based employee compensation, effective for fiscal year and interim periods beginning after December 15, 2002.

The following tables summarizes the Company's operating results as if the Company elected to account for its stock-based compensation under the fair value provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," for the three and six months ended June 30, 2004:

	Three months ended June 30, 2004	Six months ended June 30, 2004
Net income (loss), as reported	\$ 132,275	\$ (61,029)
Less: Stock-based compensation expense determined using the fair value based method	<u>(124,110)</u>	<u>(235,544)</u>
Net income (loss), pro-forma	\$ 8,165	\$ (296,573)
Basic, as reported	\$ 0.02	\$ (0.01)
Basic, pro-forma	\$ 0.00	\$ (0.04)
Diluted, as reported	\$ 0.02	\$ (0.01)
Diluted, pro-forma	\$ 0.00	\$ (0.04)

The stock-based compensation expense under the fair value method, as reported in the above table, was computed using an estimated weighted average fair value of \$1.89 using the Black-Scholes option-pricing model, based on options issued from date of inception forward, and the following assumptions: dividend yield of 5.0% percent, risk-free interest rate of 2.54%, expected volatility factor of 18.39%, and expected lives of 3 years.

There were no stock options outstanding during the period February 14, 2003 (inception) through June 30, 2003.

At June 30, 2004, 903,500 options were outstanding with exercise prices ranging from \$15 to \$16.85 with terms of ten years.

5. Earnings Per Common Share

The following tables set forth the computation of basic and diluted earnings (loss) per share for the three and six months ended June 30, 2004 and for the three months ended June 30, 2003 and for the period February 14, 2003 (inception) through June 30, 2003:

	Three months ended June 30, 2004	Three months ended June 30, 2003
Net income (loss) available to common stockholders	\$ 132,275	\$ (105)
Denominator for basic weighted average shares	7,642,000	52,000
Dilutive effect of stock options	<u>53,134</u>	<u>—</u>
Denominator for diluted weighted average shares	<u>7,695,134</u>	<u>52,000</u>
Basic earnings (loss) per common share	\$ 0.02	\$ (0.00)
Diluted earnings (loss) per common share	\$ 0.02	\$ (0.00)

	Six months ended June 30, 2004	For the period February 14, 2003 (inception) through June 30, 2003
Net loss	\$ (61,029)	\$ (10,654)
Denominator for basic weighted average shares	7,642,000	52,000
Dilutive effect of stock options	—	—
Denominator for diluted weighted average shares	<u>7,642,000</u>	<u>52,000</u>
Basic loss per common share	\$ (0.01)	\$ (0.20)
Diluted loss per common share	<u>\$ (0.01)</u>	<u>\$ (0.20)</u>

Due to the Company's net loss, the incremental shares related to stock options have an anti-dilutive effect for the six months ended June 30, 2004 and, as a result, diluted loss per average common share is equal to the basic loss per average common share.

6. Real Estate

A summary of all properties held by the Company as of June 30, 2004 is as follows:

Date Acquired	Location	Square Footage	Property Description
Dec-03	Raleigh, North Carolina	58,926	Office
Jan-04	Canton, Ohio	54,018	Office and Warehouse
Apr-04	Akron, Ohio	83,891	Office and Laboratory
Jun-04	Charlotte, North Carolina	64,500	Office

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

	June 30, 2004	December 31, 2003
Real estate:		
Land	\$ 4,119,000	\$ 960,000
Building	22,137,392	3,740,996
Tenant improvements	779,975	739,776
Accumulated depreciation	<u>(172,949)</u>	<u>(4,619)</u>
Real estate, net	<u>\$26,863,418</u>	<u>\$ 5,436,153</u>

On December 23, 2003 the Company acquired a 58,926 square foot commercial office building in Raleigh, North Carolina. The property was acquired for \$5.8 million, including transaction costs, and was funded using a portion of the net proceeds from the Company's initial public offering. The property is leased to a single tenant. The lease has a remaining term of six years. In connection with this acquisition, the Company recorded lease intangibles in the amount of \$359,228 related to the avoided costs to lease the property and obtain the current lease. These intangibles will be amortized over the remaining lease term.

On January 30, 2004, the Company acquired a 54,018 square foot commercial office and warehouse space building in Canton, Ohio for \$3.65 million, including transaction costs, and the purchase was funded using a portion of the net proceeds from the Company's initial public offering. The Company, upon acquisition of the property, extended a ten year triple net lease with the sole tenant. The monthly lease payments are the greater of the one month LIBOR rate plus 6 percent per annum or 9.25% multiplied by the purchase price.

On April 29, 2004, the Company purchased an 83,891 square foot commercial office and laboratory space in Akron, Ohio for \$9.3 million. The purchase was funded using a portion of the net proceeds of the Company's initial public offering. The property is currently leased to two tenants under separate triple net leases, one of which occupies 79% of the property and has a remaining term of eleven years and the other of which occupies 21% of the property and has a remaining term of five years. The leases provide for approximately \$410,000 of base rents during the remaining months outstanding of fiscal year 2004 with prescribed escalations thereafter.

On June 30, 2004, the Company acquired a 64,500 square foot commercial office space building in Charlotte, North Carolina for \$9.3 million including transaction costs and funded the purchase using a portion of the net proceeds from the Company's initial public offering. The Company, upon acquisition of the property, extended a fifteen year triple net lease with the sole tenant. The lease provides for approximately \$451,000 of base rents during the remaining months outstanding of fiscal year 2004 with prescribed escalations thereafter. The prescribed escalations are made at the beginning of each lease year and are based upon the annual increase of the CPI Index. The annual escalations are subject to certain floor and cap rates.

Future operating lease payments under non-cancelable leases, excluding customer reimbursement of expenses, in effect at June 30, 2004 are as follows:

<u>Year</u>	<u>Rental Payments</u>
2004	1,245,904
2005	2,767,109
2006	2,804,311
2007	2,842,307
2008	2,881,117
Thereafter	17,959,414

In accordance with the lease terms, substantially all tenant expenses are required to be paid by the tenant, however the Company would be required to pay property taxes on the respective property in the event the tenant fails to pay them.

7. Mortgage Note Receivable

On February 18, 2004, the Company extended a promissory mortgage note in the amount of \$11,170,000 collateralized by property in Sterling Heights, Michigan. The note was issued from a portion of the net proceeds of the Company's initial public offering. The note accrues interest at the greater of 10% per annum or the one month LIBOR rate plus 400 basis points per annum, and is for a period of 10 years maturing on February 18, 2014. At June 30, 2004, the outstanding balance of the note was \$11,150,787.

8. Dividends Declared per Share

During the six months ended June 30, 2004, the Company declared two quarterly dividends: \$0.12 per common share dividend to stockholders of record on March 31, 2004, which was paid on April 15, 2004, and a \$0.12 per common share dividend to stockholders of record on June 30, 2004, which is payable on July 15, 2004.

9. Subsequent Event

On July 6, 2004, the Company acquired a 228,000 square foot commercial warehouse and manufacturing building in Canton, North Carolina for \$5.2 million, including transaction costs, and the purchase was funded using a portion of the net proceeds from the Company's initial public offering. The Company, upon acquisition of the property, extended a twenty year triple net lease with the sole tenant, with a provision whereby the tenant may purchase the property from the Company on or around the fifth anniversary of the purchase date for \$5.6 million. The lease provides for approximately \$236,000 of base rents during the remaining months outstanding of fiscal year 2004 with prescribed escalations thereafter.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forward-Looking Statements

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

- our business strategy;
- pending transactions;
- our projected operating results;
- our ability to obtain future financing arrangements;
- estimates relating to our future distributions;
- our understanding of our competition;
- market trends;
- projected capital expenditures; and
- use of the proceeds of our initial public offering.

These statements involve known and unknown risks, uncertainties and other factors that may cause results, levels of activity, growth, performance, tax consequences or achievements to be materially different from any future results, levels of activity, growth, performance, tax consequences or achievements expressed or implied by such forward-looking statements. Such factors include, among other things, those listed below, as well as those further set forth under the heading "Risk Factors" included in our Annual Report on Form 10-K for the year ended December 31, 2003 filed with the SEC on March 11, 2004.

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

- the loss of any of our key employees, such as Mr. David Gladstone, our chairman and chief executive officer, Mr. Terry Lee Brubaker, our president and chief operating officer, or Mr. George Stelljes III, our executive vice president and chief investment officer;
- general volatility of the capital markets and the market price of our common stock;
- risks associated with negotiation of consummation of pending and future transactions;
- 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.

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

Overview

We were incorporated under the General Corporation Law of the State of Maryland on February 14, 2003 primarily for the purpose of investing in and owning net leased industrial and commercial rental property and selectively making long-term mortgage loans collateralized by industrial and commercial property. We expect that a large portion of our tenants and borrowers will be small and medium-sized businesses that have significant buyout fund ownership and will be well capitalized, with equity constituting between 20% and 40% of their permanent capital. We expect that other tenants and borrowers will be family-owned businesses that have built significant equity from paying down the mortgage loans securing their real estate or through the appreciation in the value of their real estate. We will seek to enter into triple net leases having terms of approximately 15 years, with rent increases built into the leases. Under a triple net lease, the tenant is required to pay all operating, maintenance and insurance costs and real estate taxes with respect to the leased property. At June 30, 2004, we owned four properties and had one mortgage loan. We have also acquired one property subsequent to June 30, 2004. We are actively communicating with buyout funds, real estate brokers and other third parties to locate properties for potential acquisition or mortgage financing in an effort to build our portfolio.

We conduct substantially all of our activities through, and all of our properties are held directly or indirectly by, Gladstone Commercial Limited Partnership, a Delaware limited partnership formed on May 28, 2003, which we refer to as our "Operating Partnership." We control our Operating Partnership as its sole general partner, and, through our wholly owned subsidiary Gladstone Commercial Partners, LLC, we also own all limited partnership units of our Operating Partnership. We expect our Operating Partnership to issue limited partnership units from time to time in exchange for industrial and commercial real property. By structuring our acquisitions in this manner, the sellers of the real estate will generally be able to defer the realization of gains until they redeem the limited partnership units. Limited partners who hold limited partnership units in our Operating Partnership will be entitled to redeem these units for cash or, at our election, shares of our common stock on a one-for-one basis at any time after the first anniversary of the completion of our initial public 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.

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

Recent Events

In August 2003, we completed our initial public offering of 7,590,000 shares of common stock (including 990,000 shares sold in September 2003 upon the exercise by the underwriters of an over-allotment option granted in connection with our initial public offering), at a public offering price of \$15 per share, resulting in aggregate net proceeds to us after underwriters' discounts and offering expenses of approximately \$105 million.

On December 23, 2003 we acquired a 58,926 square foot commercial office building in Raleigh, North Carolina. The \$5.8 million acquisition cost for the building (including transaction costs) was funded using a portion of the net proceeds of our initial public offering. The building is currently leased to a single tenant under a triple net lease with a remaining term of six years, and the tenant has an option to renew the lease for an additional five year term.

On January 30, 2004, we acquired a 54,018 square foot commercial office and warehouse building in Canton, Ohio. The \$3.65 million acquisition cost for the building (including transaction costs) was funded using a portion of the net proceeds of our initial public offering. This building has been leased to one tenant under a 10 year triple net lease. The monthly lease payments are the greater of the one month LIBOR rate plus 6 percent per annum or 9.25% multiplied by the purchase price.

On February 18, 2004, we extended a mortgage loan in the amount of \$11.17 million for the purchase of a commercial property in Sterling Heights, Michigan. The loan was funded using a portion of the net proceeds of our initial public offering. This 10 year mortgage loan, collateralized by the Sterling Heights property, accrues interest at the greater of 10% per annum or the one month LIBOR rate plus four percent per annum.

On April 29, 2004, we purchased an 83,891 square foot commercial office and laboratory space in Akron, Ohio for \$9.3 million. The purchase was funded using a portion of the net proceeds of our initial public offering. The property is currently leased to two tenants under separate triple net leases, one of which occupies 79% of the property and has a remaining term of eleven years, and the second of which occupies 21% of the property and has a remaining term of five years.

On June 30, 2004, we acquired a 64,500 square foot commercial office space building in Charlotte, North Carolina for \$9.3 million including transaction costs. The purchase was funded using a portion of the net proceeds from our initial public offering. Upon acquisition of the property, we extended a fifteen year triple net lease with the sole tenant. The lease provides for approximately \$451,000 of base rents during the remaining months outstanding of fiscal year 2004 with prescribed escalations thereafter.

On July 6, 2004, we acquired a 228,000 square foot commercial warehouse and manufacturing building in Canton, North Carolina for \$5.2 million including transaction costs and the purchase was funded using a portion of the net proceeds of our initial public offering. Upon acquisition of the property, we extended a twenty year triple net lease with the sole tenant, with a provision whereby the tenant may purchase the property from us on or around the fifth anniversary of the purchase date for \$5.6 million. The lease provides for approximately \$236,000 of base rents during the remaining months outstanding of fiscal year 2004 with prescribed escalations thereafter.

Expenses

Our Adviser currently has an expense sharing arrangement with Gladstone Capital Advisers, a wholly-owned subsidiary of our affiliate, Gladstone Capital Corporation, through which our entire workforce is employed. Under that relationship, our Adviser reimburses Gladstone Capital Advisers for a portion of Gladstone Capital Advisers' total payroll and benefits expenses (based on the percentage of total hours worked by Gladstone Capital Advisers' employees on our matters on an employee-by-employee basis) and a portion of Gladstone Capital Advisers' total overhead expense (based on the percentage of total hours worked by all Gladstone Capital Advisers' employees on our matters). In turn, subject to the terms and conditions of our advisory agreement, Gladstone Management passes these charges on to us.

During the three and six months ended June 30, 2004, payroll and benefits expenses were approximately \$215,000 and \$380,000, respectively. The actual amount of payroll and benefits expenses which we will be required to reimburse our Adviser in the future is not determinable, but we currently estimate that during the year ending December 31, 2004 this amount will be approximately \$830,000. This estimate is based on our current expectations regarding our Adviser's payroll and benefits expenses and the proportion of our Adviser's time we believe will be spent on matters relating to our business. To the extent that our Adviser's payroll and benefits expenses are greater than we expect or our Adviser allocates a greater percentage of its time to our business, our actual reimbursement of our Adviser for our share of its payroll and benefits expenses could be materially greater than we currently project.

During the three and six months ended June 30, 2004, the amount of overhead expenses that we reimbursed our Adviser was approximately \$65,000 and \$128,000, respectively. The actual amount of overhead expenses for which we will be required to reimburse our Adviser in the future is not determinable, but we currently estimate that during the year ending December 31, 2004 this amount will be approximately \$275,000.

Under the terms of the advisory agreement, we are responsible for all expenses incurred for our direct benefit. Examples of these expenses include expenses incurred in connection with our organization and initial public offering, legal, accounting, tax preparation, consulting and related fees. During the three and six months ended June 30, 2004, the total amount of these expenses that we incurred was approximately \$306,000 and \$694,000, respectively.

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

Critical Accounting Policies

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

Revenue Recognition

Rental revenues include rents that each tenant pays in accordance with the terms of its respective lease reported on a straight-line basis over the initial term of the lease. Since three of the Company's leases currently contain rental increases at specified intervals, straight-line basis accounting will require us to record as an asset, and include in revenues, deferred rent receivable that we will only receive if the tenant makes all rent payments required through the expiration of the initial term of the lease. Deferred rent receivable in the accompanying balance sheet represents the cumulative difference between rental revenue as recorded on a straight-line basis and rents received from the tenants in accordance with the lease terms. Accordingly, our management must determine, in its judgment, to what extent the deferred rent receivable applicable to each specific tenant is collectible. We review deferred rent receivable on a quarterly basis and take into consideration the tenant's payment history, the financial condition of the tenant, business conditions in the industry in which the tenant operates and economic conditions in the area in which the property is located. In the event that the collectability of deferred rent with respect to any given tenant is in doubt, we would 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.

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

Purchase Price Allocation

We record above-market and below-market in-place lease values for owned properties based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. We amortize the capitalized above-market lease values as a reduction of rental income over the remaining non-cancelable terms of the respective leases. We amortize the capitalized below-market lease values (presented in the accompanying balance sheet as value of assumed lease obligations) as an increase to rental income over the initial term and any fixed-rate renewal periods in the respective leases. Since our strategy to a large degree involves sale-leaseback transactions with newly originated leases at market rates, the above-market and below-market in-place lease values are generally not significant.

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

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

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

Investments in Real Estate

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

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

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

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

Provision for Loan Losses

Our accounting policies require that we reflect in our financial statements an allowance for estimated credit losses with respect to mortgage loans we have made based upon our evaluation of known and inherent risks associated with our private lending assets. We have only recently extended one mortgage loan and have not experienced any actual losses in connection with our lending investments. Management will 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.

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. As of June 30, 2004, we were not a party to any separate derivatives contract. Certain of our leases and loans contain embedded derivatives which do not require separate accounting.

Income Taxes

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

Stock Based Compensation

We apply the intrinsic value method to account for the issuance of stock options under our 2003 Equity Incentive Plan in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees," where appropriate. In this regard, the substantial portion of these options were granted to individuals who are our officers and who qualify as leased employees under FIN 44, "Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25." Accordingly, because the grants were at exercise prices equal to the fair value of the stock at date of grant, we did not record any expense related to the issuance of these options under the intrinsic value method.

Results of Operations

For the three months ended June 30, 2003

Results of operations for the three months ended June 30, 2003 are not comparative because operations had only recently begun and there was minimal activity during this period.

For the three months ended June 30, 2004

Revenues

For the three months ended June 30, 2004, we earned \$403,690 of rental revenue, representing three months of rent from our Raleigh, North Carolina property and our Canton, Ohio property, and approximately two months of rent from our Akron, Ohio property acquired on April 29, 2004.

We recorded interest income of \$278,980 for the three months ended June 30, 2004, which represents interest income on the mortgage loan that we extended for the purchase of a Sterling Heights, Michigan commercial property.

Expenses

Operating expenses for the three months ended June 30, 2004 were \$712,918. Operating expenses mainly consist of the management advisory fee, depreciation and amortization, and general and administrative expenses. The management advisory fee consists of the reimbursement of expenses, including direct allocation of employee salaries and benefits, as well as general overhead expense, to our adviser in accordance with the terms of the advisory agreement. For the three months ended June 30, 2004, the management advisory fee was \$280,122.

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

Depreciation and amortization expenses of \$126,772 were recorded for the three months ended June 30, 2004. General and administrative expenses were \$306,024 for the three months ended June 30, 2004 and consisted mainly of incurred insurance expense for directors and officers insurance, as well as general insurance, directors fees, professional fees (consisting of legal and accounting fees), and also stockholder-related expenses.

Interest Income

During the three months ended June 30, 2004, we earned interest income on cash and cash equivalents of \$162,523. This interest represents the interest earned on the investment of the net proceeds from our initial public offering in short-term investment grade securities, primarily U.S. Treasury Bills. As we increase our portfolio of investments in real estate and mortgage loans, we anticipate that the interest earned on cash and cash equivalents will decrease.

Net Income

For the three months ended June 30, 2004, we recorded net income of \$132,275. Based on the basic and diluted weighted average common shares outstanding of 7,642,000 and 7,695,134, respectively, for the three months ended June 30, 2004, the basic and diluted earnings per weighted average common share was \$0.02.

For the period from February 14, 2003 (inception) to June 30, 2003

Results of operations for the period from February 14, 2003 (inception) to June 30, 2003 are not comparative because operations had only recently begun and there was minimal activity during this period.

For the six months ended June 30, 2004

Revenues

For the six months ended June 30, 2004, we earned \$601,463 of rental revenue, representing six months of rent from our Raleigh, North Carolina property, approximately five months of rent from our Canton, Ohio property, which was acquired in January 2004, and approximately two months of rent from our Akron, Ohio property acquired on April 29, 2004.

We recorded interest income of \$412,400 for the six months ended June 30, 2004, which represents approximately five months of interest income on the mortgage loan that we extended in February 2004 for the purchase of a Sterling Heights, Michigan commercial property.

Expenses

Operating expenses for the six months ended June 30, 2004 were \$1,409,877. Operating expenses mainly consist of the management advisory fee, depreciation and amortization, and general and administrative expenses. The management advisory fee consists of the reimbursement of expenses, including direct allocation of employee salaries and benefits as well as general overhead cost to our Adviser in accordance with the terms of the advisory agreement. For the six months ended June 30, 2004, the management advisory fee was \$509,538.

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

Depreciation and amortization expenses of \$206,101 were recorded for the six months ended June 30, 2004. General and administrative expenses were \$694,238 for the six months ended June 30, 2004 and consisted mainly of incurred insurance expense for directors and officers insurance, as well as general insurance, directors fees, professional fees (consisting of legal and accounting fees), and also stockholder-related expenses such as the printing of our 2003 annual report.

Interest Income

During the six months ended June 30, 2004, we earned interest income on cash and cash equivalents of \$334,985. This interest represents the interest earned on the investment of the net proceeds from our initial public offering in short-term investment grade securities, primarily U.S. Treasury Bills. As we increase our portfolio of investments in real estate and mortgage loans, we anticipate that the interest earned on cash and cash equivalents will decrease.

Net Loss

For the six months ended June 30, 2004, we incurred a net loss of \$61,029. Based on the basic and diluted weighted average common shares outstanding of 7,642,000 and 7,764,732, respectively, for the three months ended June 30, 2004, the basic and diluted loss per weighted average common share was \$0.01.

Liquidity and Capital Resources

Cash and Cash Equivalents

At June 30, 2004, we had approximately \$65.0 million in cash and cash equivalents available to make investments and fund our continuing operations, a decrease of \$34.0 million from \$99.0 million at December 31, 2003. The funds on hand were predominantly raised through our initial public offering in 2003.

Operating Activities

Net cash provided by operating activities during the six months ended June 30, 2004 was \$357,408, consisting primarily of a decrease in prepaid assets, increases in rent received in advance and security deposits and an increase in accrued expenses and accounts payable, partially offset by a decrease in amounts due our adviser and an increase in mortgage interest receivable.

Investing Activities

Net cash used in investing activities during the six months ended June 30, 2004 was \$33.4 million, which consisted of our purchase of the Canton, Ohio commercial office and warehouse property in January 2004, the Akron, Ohio commercial office and laboratory space in April 2004, the Charlotte, North Carolina commercial office space in June 2004 and our extension of a mortgage loan of approximately \$11.2 million on the Sterling Heights, Michigan commercial property in February 2004.

On July 6, 2004, we purchased a 228,000 square foot commercial warehouse and manufacturing space in Canton, North Carolina for \$5.2 million.

Financing Activities

Net cash used in financing activities for the six months ended June 30, 2004 was \$1.0 million. These amounts consisted of the dividend payments to our stockholders of \$993,460 and of costs associated with our initial public offering of \$7,730. Net cash provided by financing activities was \$29,615 for the period from inception through June 30, 2003 and consisted of the proceeds from the initial issuance of common stock from our founder in connection with our formation of \$52,000, less payment of \$22,385 in deferred financing costs.

Future Capital Needs

We had purchase commitments at June 30, 2004 of \$41.4 million, which included \$5.2 million related to real estate purchased on July 6, 2004.

As of August 4, 2004, we have invested approximately \$44.4 million, or 42%, of the net proceeds from our initial public offering in real properties and mortgage loans. Investments in five real properties account for approximately \$33.2 million of the currently invested net proceeds, and an investment in one mortgage loan accounts for approximately \$11.2 million of the currently invested net proceeds. During the remainder of 2004 and beyond, we expect to complete additional acquisitions of real estate and to extend additional mortgage notes. We expect to finance these activities as we have in the past, using the funds on hand predominately raised through our initial public offering in 2003. We anticipate that the remaining net proceeds will be sufficient to fund our real estate investments for the foreseeable future. However, once the net proceeds of our initial public offering have been substantially fully invested, we intend to acquire additional properties by borrowing all or a portion of the purchase price and collateralizing the loan with a mortgage on some or all of our real property. If we were unable to make any required debt payments on any borrowings we make in the future, our lenders could foreclose on the properties collateralizing their loans, which could cause us to lose part or all of our investments in such properties. We also may issue additional equity securities in the future to finance future investment although there can be no assurance that we would be able to do so on favorable terms if at all.

Funds from Operations

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

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

Diluted funds from operations per share ("Diluted FFO per share") is FFO divided by weighted average common shares outstanding on a diluted basis during a period. We believe that Diluted FFO per share is useful to investors because it provides investors with a further context for evaluating our FFO results in the same manner that investors use earnings per share ("EPS") in evaluating net income available to common shareholders. In addition, since most REITs provide Diluted FFO per share information to the investment community, we believe Diluted FFO per share is a useful supplemental measure for comparing us to other REITs. We believe that diluted EPS is the most directly comparable GAAP measure to Diluted FFO per share.

The following table provides a reconciliation of our FFO for the three and six months ended June 30, 2004 to the most directly comparable GAAP measure, net income (loss), and a computation of diluted FFO per weighed average common share and diluted net income (loss) per weighted average common share.

	Three months ended June 30, 2004	Six months ended June 30, 2004
Net income (loss)	\$ 132,275	\$ (61,029)
Real estate depreciation and amortization	<u>126,772</u>	<u>206,101</u>
Funds from operations	<u>259,047</u>	<u>145,072</u>
Weighted average shares outstanding - diluted	7,695,134	7,764,732
Diluted net income (loss) per weighted average common share	<u>\$ 0.02</u>	<u>\$ (0.01)</u>
Diluted funds from operations per weighted average common share	<u>\$ 0.03</u>	<u>\$ 0.02</u>

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Market risk includes risks that arise from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market sensitive instruments. The primary risk that we believe we will be exposed to is interest rate risk.

In the future, 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 are to limit the impact of interest rate changes on earnings and cash flows and to lower overall borrowing costs. To achieve this objective, we will borrow primarily at fixed rates or variable rates with the lowest margins available and, in some cases, with the ability to convert variable rates to fixed rates. We may also enter into derivative financial instruments such as interest rate swaps and caps in order to mitigate the interest rate risk on a related financial instrument. We will not enter into derivative or interest rate transactions for speculative purposes.

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

Item 4. Controls and Procedures

a) Evaluation of Disclosure Controls and Procedures

As of June 30, 2004, our management, including the chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, management, including the chief executive officer and chief financial officer, concluded that the disclosure controls and procedures were effective in timely alerting management of material information about the company required to be included in our periodic Securities and Exchange Commission filings. However, while evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply judgment in evaluating the cost-benefit relationship of possible controls and procedures.

b) Change in Internal Control over Financial Reporting

There were no changes in internal controls for the period ended June 30, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 2. Changes in Securities and Use of Proceeds

As of June 30, 2004, we had invested approximately \$39.2 million of the net proceeds from our initial public offering in four real properties and one mortgage loan. As of June 30, 2004, we had used approximately \$1.8 million in our operating activities, of which approximately \$827,000 has been paid to our Adviser (which is an affiliate of ours) in partial payment of amounts owed under our advisory agreement. As of June 30, 2004, substantially all of the remaining net proceeds from our initial public offering were invested in short-term, investment grade, interest-bearing instruments.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

The Annual Meeting of Stockholders was held on May 26, 2004. The stockholders voted and approved of the following matters:

- The election of three Class I directors to hold office until the 2007 Annual Meeting of Stockholders.

<u>Nominee</u>	<u>Shares Voted For</u>	<u>Authority Withheld</u>
David Gladstone	7,524,223	26,548
Paul Adलगren	6,567,239	983,532
John Outland	7,525,073	25,698

- An amendment to the investment policies to permit us to make leases to existing and prospective portfolio companies of current or future affiliates.

Shares voted for	3,580,375
Shares voted against	1,132,853
Shares abstained	517,528

- An amendment to our Amended and Restated 2003 Equity Incentive Plan to increase the aggregate number of shares of common stock authorized for issuance to 960,000 shares.

Shares voted for	3,435,854
Shares voted against	1,741,477
Shares abstained	53,516

- The ratification of PricewaterhouseCoopers LLP as our independent auditors for the fiscal year ending December 31, 2004.

Shares voted for	7,489,508
Shares voted against	34,413
Shares abstained	26,850

Item 5. Other Information.

Not applicable.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

See Exhibit Index.

(b) Reports on Form 8-K:

On May 11, 2004, we furnished to the SEC under Item 12 of Form 8-K our press release, dated May 10, 2004, announcing our results of operations for the quarter ended March 31, 2004. In accordance with the regulations of the SEC, this report was deemed to be furnished to, rather than filed with, the SEC.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GLADSTONE COMMERCIAL CORPORATION

By: /s/ Harry Brill
Harry Brill
Chief Financial Officer

Date: August 4, 2004

Exhibit Index

Exhibit	Description of Document
3.1†	Amended and Restated Articles of Incorporation of the Registrant, incorporated by reference to the Registration Statement on Form S-11 (File No. 333-106024), filed June 11, 2003.
3.2†	Bylaws of the Registrant, incorporated by reference to the Registrant, incorporated by reference to the Registration Statement on Form S-11 (File No. 333-106024), filed June 11, 2003.
11	Computation of earnings (loss) per common share (included in the notes to the unaudited financial statements contained in this report.)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.

† Previously filed.

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

I, David Gladstone, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Gladstone Commercial Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 4, 2004

/s/ DAVID GLADSTONE

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

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

I, Harry Brill, certify that:

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

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

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

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

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

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

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

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

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

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

Date: August 4, 2004

/s/ HARRY BRILL

Harry Brill
Chief Financial Officer and Treasurer

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

The undersigned, the Chief Executive Officer of Gladstone Commercial Corporation (the "Company"), hereby certifies on the date hereof, pursuant to 18 U.S.C. §1350(a), as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 ("Form 10-Q"), filed concurrently herewith by the Company, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 4, 2004

/s/ David Gladstone

David Gladstone
Chief Executive Officer

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

The undersigned, the Chief Financial Officer of Gladstone Commercial Corporation (the "Company"), hereby certifies on the date hereof, pursuant to 18 U.S.C. §1350(a), as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 ("Form 10-Q"), filed concurrently herewith by the Company, fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, and that the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 4, 2004

/s/ Harry Brill

Harry Brill
Chief Financial Officer