GLADSTONE COMMERCIAL CORP
Form 10-Q
July 25, 2016
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO
COMMISSION FILE NUMBER: 001-33097
GLADSTONE COMMERCIAL CORPORATION
(Exact name of registrant as specified in its charter)

MARYLAND	02-0681276
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1521 WESTBRANCH DRIVE, SUITE 100 MCLEAN, VIRGINIA	22102
(Address of principal executive offices)	(Zip Code)

(703) 287-5800
(Registrant’s telephone number, including area code)
Not Applicable
(Former name, former address and formal fiscal year, if changed since last report)

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 ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer ý
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

The number of shares of the registrant’s Common Stock, $0.001 par value, outstanding as of July 25, 2016 was 22,583,722.

1

Table of Contents

GLADSTONE COMMERCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED
June 30, 2016
TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION
Item 1. Financial Statements
Gladstone Commercial Corporation
Condensed Consolidated Balance Sheets
(Dollars in Thousands, Except Share and Per Share Data)
(Unaudited)

	June 30, 2016	December 31, 2015
ASSETS		
Real estate, at cost	$790,232	$780,377
Less: accumulated depreciation	122,827	112,243
Total real estate, net	667,405	668,134
Lease intangibles, net	101,683	104,914
Real estate and related assets held for sale, net	3,820	1,077
Mortgage note receivable	—	5,900
Cash and cash equivalents	3,993	5,152
Restricted cash	3,902	4,205
Funds held in escrow	5,922	7,534
Deferred rent receivable, net	28,909	27,443
Other assets	2,651	2,825
TOTAL ASSETS	$818,285	$827,184
LIABILITIES, MEZZANINE EQUITY AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Mortgage notes payable, net	$441,604	$455,863
Borrowings under line of credit, net	60,229	44,591
Borrowings under term loan facility, net	24,887	24,878
Series C mandatorily redeemable preferred stock, net, par value $0.001 per share; $25 per share liquidation preference; 1,700,000 shares authorized; and 540,000 and 1,540,000 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	13,424	38,100
Deferred rent liability, net	8,964	9,657
Asset retirement obligation	3,645	3,674
Accounts payable and accrued expenses	3,681	6,388
Liabilities related to assets held for sale	357	868
Due to Adviser and Administrator (1)	1,884	1,858
Other liabilities	7,523	7,436
TOTAL LIABILITIES	$566,198	$593,313
Commitments and contingencies (2)		
MEZZANINE EQUITY		
Series D redeemable preferred stock, net, par value $0.001 per share; $25 per share liquidation preference; 6,000,000 shares authorized; and 1,063,705 shares issued and outstanding at June 30, 2016 (3)	$25,532	$—
TOTAL MEZZANINE EQUITY	$25,532	$—
STOCKHOLDERS' EQUITY		
Series A and B redeemable preferred stock, par value $0.001 per share; $25 per share liquidation preference; 5,350,000 and 2,300,000 shares authorized and 2,264,000 and 2,150,000 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	$2	$2
Senior common stock, par value $0.001 per share; 4,450,000 and 7,500,000 shares authorized and 959,552 and 972,214 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	1	1

Common stock, par value $0.001 per share, 32,500,000 and 38,500,000 shares authorized and 22,983,604 and 22,485,607 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	23	22
Additional paid in capital	429,608	418,897
Distributions in excess of accumulated earnings	(203,079)	(185,051)
TOTAL STOCKHOLDERS' EQUITY	226,555	233,871
TOTAL LIABILITIES, MEZZANINE EQUITY AND STOCKHOLDERS’ EQUITY	$818,285	$827,184

(1) Refer to Note 2 "Related-Party Transactions"
(2) Refer to Note 9 “Commitments and Contingencies”
(3) Refer to Note 10 “Stockholders' Equity and Mezzanine Equity”

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

Table of Contents

Gladstone Commercial Corporation
Condensed Consolidated Statements of Operations
(Dollars in Thousands, Except Share and Per Share Data)
(Unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Operating revenues				
Rental revenue	$20,890	$ 20,012	$41,547	$ 39,300
Tenant recovery revenue	357	394	842	718
Interest income from mortgage note receivable	—	282	385	549
Total operating revenues	21,247	20,688	42,774	40,567
Operating expenses				
Depreciation and amortization	9,205	8,947	18,338	17,154
Property operating expenses	1,434	1,178	3,045	2,139
Acquisition related expenses	117	255	126	451
Base management fee (1)	856	866	1,717	1,717
Incentive fee (1)	655	1,760	1,273	3,433
Administration fee (1)	370	366	775	728
General and administrative	609	539	1,184	1,229
Impairment charge	187	—	230	—
Total operating expenses before credit to incentive fee	13,433	13,911	26,688	26,851
Credit to incentive fee (1)	—	(1,316)	—	(2,500)
Total operating expenses	13,433	12,595	26,688	24,351
Other (expense) income				
Interest expense	(6,579)	(6,999)	(13,310)	(13,770)
Distributions attributable to Series C mandatorily redeemable preferred stock	(686)	(686)	(1,372)	(1,372)
Other income	334	23	334	51
Total other expense	(6,931)	(7,662)	(14,348)	(15,091)
Net income	883	431	1,738	1,125
Distributions attributable to Series A, B and D preferred stock	(1,263)	(1,023)	(2,290)	(2,047)
Distributions attributable to senior common stock	(251)	(261)	(504)	(485)
Net loss attributable to common stockholders	$(631)	$ (853)	$(1,056)	$ (1,407)
Loss per weighted average share of common stock - basic & diluted				
Loss attributable to common shareholders	$(0.03)	$ (0.04)	$(0.05)	$ (0.07)
Weighted average shares of common stock outstanding				
Basic	22,684,391	20,833,787	22,614,838	20,524,101
Diluted	22,684,391	20,833,787	22,614,838	20,524,101
Earnings per weighted average share of senior common stock	$0.26	$ 0.26	$0.52	$ 0.52
Weighted average shares of senior common stock outstanding - basic	959,552	995,852	961,794	928,323

(1) Refer to Note 2 “Related-Party Transactions”
The accompanying notes are an integral part of these condensed consolidated financial statements.

Gladstone Commercial Corporation
Condensed Consolidated Statements of Cash Flows
(Dollars in Thousands)
(Unaudited)

	For the six months ended June 30, 2016	2015
Cash flows from operating activities:		
Net income	$1,738	$1,125
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,338	17,154
Impairment charge	230	—
Amortization of deferred financing costs	1,090	878
Amortization of deferred rent asset and liability, net	(215)	(270)
Amortization of discount and premium on assumed debt	(116)	(154)
Asset retirement obligation expense	73	76
Decrease (increase) in other assets	196	(538)
Increase in deferred rent receivable	(1,959)	(1,843)
(Decrease) increase in accounts payable, accrued expenses, and amount due Adviser and Administrator	(655)	1,021
Decrease in other liabilities	(402)	(683)
Leasing commissions paid	(486)	(291)
Net cash provided by operating activities	17,832	16,475
Cash flows from investing activities:		
Acquisition of real estate and related intangible assets	(17,000)	(58,248)
Improvements of existing real estate	(2,654)	(3,072)
Proceeds from sale of real estate	200	—
Issuance of mortgage note receivable	—	(300)
Collection of mortgage note receivable	5,900	—
Receipts from lenders for funds held in escrow	2,719	642
Payments to lenders for funds held in escrow	(1,107)	(1,924)
Receipts from tenants for reserves	1,840	2,037
Payments to tenants from reserves	(1,505)	(1,308)
Decrease (increase) in restricted cash	303	(800)
Deposits on future acquisitions	(500)	(1,600)
Deposits applied against acquisition of real estate investments	500	1,400
Net cash used in investing activities	(11,304)	(63,173)
Cash flows from financing activities:		
Proceeds from issuance of equity	37,669	30,363
Offering costs paid	(1,247)	(742)
Retirement of senior common stock	(178)	—
Redemption of Series C mandatorily redeemable preferred stock	(25,000)	—
Borrowings under mortgage notes payable	37,905	51,819
Payments for deferred financing costs	(690)	(883)
Principal repayments on mortgage notes payable	(51,977)	(23,625)
Principal repayments on employee notes receivable	—	375
Borrowings from line of credit	71,000	56,400
Repayments on line of credit	(55,500)	(54,500)
Increase in security deposits	97	108

Distributions paid for common, senior common and preferred stock	(19,766)	(17,919)
Net cash (used in) provided by financing activities	(7,687)	41,396
Net decrease in cash and cash equivalents	$(1,159)	$(5,302)
Cash and cash equivalents, beginning of period	$5,152	$8,599
Cash and cash equivalents, end of period	$3,993	$3,297
NON-CASH INVESTING AND FINANCING INFORMATION		
Increase in asset retirement obligation assumed in acquisition	$—	$56
Senior common dividend issued in the dividend reinvestment program	$—	$52
Capital improvements included in accounts payable and accrued expenses	$2,461	$2,922

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

Table of Contents

Gladstone Commercial Corporation
Notes to Condensed Consolidated Financial Statements (Unaudited)
1. Organization, Basis of Presentation and Significant Accounting Policies
Gladstone Commercial Corporation is a real estate investment trust, or REIT, that was incorporated under the General Corporation Law of the State of Maryland on February 14, 2003. We focus on acquiring, owning and managing primarily office and industrial properties. On a selective basis, we may make long term industrial and commercial mortgage loans; however, we do not have any mortgage loans currently outstanding. Subject to certain restrictions and limitations, our business is managed by Gladstone Management Corporation, a Delaware corporation, or the Adviser, and administrative services are provided by Gladstone Administration, LLC, a Delaware limited liability company, or the Administrator, each pursuant to a contractual arrangement with us. Our Adviser and Administrator collectively employ all of our personnel and pay their salaries, benefits, and general expenses directly. Gladstone Commercial Corporation conducts substantially all of its operations through a subsidiary, Gladstone Commercial Limited Partnership, a Delaware limited partnership, or the Operating Partnership.
All further references herein to “we,” “our,” “us” and the “Company” mean Gladstone Commercial Corporation and its consolidated subsidiaries, except where it is made clear that the term means only Gladstone Commercial Corporation.
Interim Financial Information
Our interim financial statements are prepared in accordance with U.S. generally accepted accounting principles, or GAAP, for interim financial information and pursuant to the requirements for reporting on Form 10-Q and in accordance with Article 10 of Regulation S-X. Accordingly, certain disclosures accompanying annual financial statements prepared in accordance with GAAP are omitted. The year-end balance sheet data presented herein was derived from audited financial statements, but does not include all disclosures required by GAAP. In the opinion of our management, all adjustments, consisting solely of normal recurring accruals, necessary for the fair presentation of financial statements for the interim period, have been included. The interim financial statements and notes thereto should be read in conjunction with the financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the U.S. Securities and Exchange Commission on February 17, 2016. The results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the results that may be expected for other interim periods or for the full fiscal year.
Use of Estimates
The preparation of financial statements in conformity with GAAP 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 periods. Actual results could materially differ from those estimates.
Critical Accounting Policies
The preparation of our financial statements in accordance with GAAP requires management to make judgments that are subjective in nature in order to make certain estimates and assumptions. Application of these accounting policies involves the exercise of judgment regarding the use of assumptions as to future uncertainties, and as a result, actual results could materially differ from these estimates. A summary of all of our significant accounting policies is provided in Note 1 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015. There were no material changes to our critical accounting policies during the six months ended June 30, 2016; however we issued mezzanine equity during the six months ended June 30, 2016, which is further described in Note 10.

Table of Contents

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, "Leases: Amendments to the FASB Accounting Standards Codification" ("ASU 2016-02"), The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. ASU 2016-02 is expected to minimally impact our consolidated financial statements as we currently have four operating ground lease arrangements for which we are the lessee. We also expect our legal expense to increase as the new standard requires us to expense indirect leasing costs that were previously capitalized to leasing commissions. ASC 2016-02 supersedes the previous leases standard, ASC 840 Leases. The standard is effective on January 1, 2019, with early adoption permitted.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs" ("ASU-2015-03"), which simplifies the presentation of debt issuance costs. ASU 2015-03 requires the presentation of debt issuance costs in the balance sheet as a deduction from the carrying amount of the related debt liability instead of a deferred financing cost. ASU 2015-03 was effective for annual periods beginning after December 15, 2015. We have adopted the provisions of ASU 2015-03 for the six months ended June 30, 2016. We had unamortized deferred financing fees of $5.7 million and $6.1 million as of June 30, 2016 and December 31, 2015, respectively. These costs have been reclassified from deferred financing costs, net, to mortgage notes payable, net, borrowings under line of credit, net, borrowings under term loan facility, net, and Series C mandatorily redeemable preferred stock, net. All periods presented have been retrospectively adjusted.

The following table summarizes the retrospective adjustment and the overall impact on the previously reported consolidated financial statements (dollars in thousands):

	December 31, 2015	
	As Previously Reported	Retrospective Application
Deferred financing costs, net	$ 6,138	$ —
Mortgage notes payable, net	460,770	455,863
Borrowings under line of credit, net	45,300	44,591
Borrowings under term loan facility, net	25,000	24,878
Series C mandatorily redeemable preferred stock, net	38,500	38,100

2. Related-Party Transactions

Gladstone Management and Gladstone Administration

We are externally managed pursuant to contractual arrangements with our Adviser and our Administrator, which collectively employ all of our personnel and pay their salaries, benefits, and general expenses directly. Both our Adviser and Administrator are affiliates of ours, as their parent company is owned and controlled by Mr. David Gladstone, our chairman and chief executive officer. Two of our executive officers, Mr. Gladstone and Mr. Terry Brubaker (our vice chairman and chief operating officer) serve as directors and executive officers of our Adviser and our Administrator. Mr. Michael LiCalsi, our general counsel and secretary, serves as our Administrator's president. We have an advisory agreement with our Adviser, and an administration agreement with our Administrator, or the Administration Agreement. The services and fees under the advisory agreement and Administration Agreement are described below. At June 30, 2016 and December 31, 2015, $1.9 million and $1.9 million, respectively, was collectively due to our Adviser and Administrator.

7

Base Management Fee
On July 24, 2015, we entered into a second amended and restated advisory agreement, or the Second Amended Advisory Agreement, with the Adviser. Our entrance into the agreement was approved unanimously by our Board of Directors, including separate and unanimous approval by the independent directors on our Board of Directors. Our Board of Directors generally reviews and considers approving or renewing the agreement with our Adviser each July. Pursuant to the terms of the Second Amended Advisory Agreement, effective July 1, 2015, the calculation of the annual base management fee equals 1.5% of our adjusted total stockholders' equity, which is our total stockholders' equity (before giving effect to the base management fee and incentive fee), adjusted to exclude the effect of any unrealized gains or losses that do not affect realized net income (including impairment charges) and adjusted for any one-time events and certain non-cash items (the later to occur for a given quarter only upon the approval of our Compensation Committee). The fee is calculated and accrued quarterly as 0.375% per quarter of such adjusted total stockholders' equity figure. On July 12, 2016, we entered into a third amended and restated advisory agreement, to amend the definition of our adjusted total stockholders' equity to include total mezzanine equity. The amendment is effective as of July 1, 2016.
Prior to entering into the Second Amended Advisory Agreement on July 24, 2015, our then-existing advisory agreement with the Adviser, or the Former Advisory Agreement, provided for an annual base management fee equal to 2.0% of our common stockholders' equity, which was our total stockholders' equity, less the recorded value of any preferred stock and adjusted to exclude the effect of any unrealized gains, losses, or other items that did not affect realized net income (including impairment charges).
For the three and six months ended June 30, 2016, we recorded a base management fee of $0.9 million and $1.7 million, respectively, and for the three and six months ended June 30, 2015, we recorded a base management fee of $0.9 million and $1.7 million, respectively.
Incentive Fee
Under the Second Amended Advisory Agreement, effective July 1, 2015, the calculation of the incentive fee was revised to reward the Adviser in circumstances where our quarterly Core FFO (defined at the end of this paragraph), before giving effect to any incentive fee, or pre-incentive fee Core FFO, exceeds 2.0% quarterly, or 8.0% annualized, of adjusted total stockholders' equity (after giving effect to the base management fee but before giving effect to the incentive fee). We refer to this as the new hurdle rate. The Adviser will receive 15.0% of the amount of our pre-incentive fee Core FFO that exceeds the new hurdle rate. However, in no event shall the incentive fee for a particular quarter exceed by 15.0% (the cap) the average quarterly incentive fee paid by us for the previous four quarters (excluding quarters for which no incentive fee was paid). Core FFO is defined as GAAP net income (loss) available to common stockholders, excluding the incentive fee, depreciation and amortization, any realized and unrealized gains, losses or other non-cash items recorded in net income (loss) available to common stockholders for the period, and one-time events pursuant to changes in GAAP.
The incentive fee under the Former Advisory Agreement rewarded the Adviser in circumstances where our quarterly FFO, before giving effect to any incentive fee, or pre-incentive fee FFO, exceeded 1.75%, or 7.0% annualized, or the hurdle rate, of common stockholders' equity. Funds from operations, or FFO, included any realized capital gains and capital losses, less any distributions paid on preferred stock and Senior Common Stock, but FFO did not include any unrealized capital gains or losses (including impairment charges). The Adviser received 100.0% of the amount of the pre-incentive fee FFO that exceeded the hurdle rate, but was less than 2.1875% of our common stockholders' equity. The Adviser also received an incentive fee of 20.0% of the amount of our pre-incentive fee FFO that exceeded 2.1875% of common stockholders' equity.

For the three and six months ended June 30, 2016, we recorded an incentive fee of $0.7 million and $1.3 million, respectively, offset by credits related to unconditional, voluntary and irrevocable waivers issued by the Adviser of $0.0 million and $0.0 million, respectively, resulting in a net incentive fee for the three and six months ended June 30, 2016, of $0.7 million and $1.3 million, respectively. For the three and six months ended June 30, 2015, we recorded an incentive fee of $1.8 million and $3.4 million, respectively, offset by credits related to unconditional, voluntary and irrevocable waivers issued by the Adviser of $1.3 million and $2.5 million, respectively, resulting in a net incentive fee for the three and six months ended June 30, 2015, of $0.5 million and $0.9 million, respectively. Our Board of Directors accepted the Adviser's offer to waive, on a quarterly basis, a portion of the incentive fee for the three and six months covering January 1, 2015 through June 30, 2015 in order to support the current level of distributions to our stockholders. The Adviser did not waive any portion of the incentive fee for the three and six months ended June 30, 2016. Waivers cannot be recouped by the Adviser in the future.

Table of Contents

On July 12, 2016, we amended and restated our existing advisory agreement with our Adviser by entering into a third amended adn restated advisory agreement, to redefine the definition of adjusted stockholders' equity, to include total mezzanine equity, in the calculation of both the base management and incentive fee. All other provisions remained unchanged. The revision was effective as of July 1, 2016.

Capital Gain Fee

Under the Second Amended Advisory Agreement, effective July 1, 2015, we will pay to the Adviser a capital gains-based incentive fee that will be calculated and payable in arrears as of the end of each fiscal year (or upon termination of the agreement). In determining the capital gain fee, we will calculate aggregate realized capital gains and aggregate realized capital losses for the applicable time period. For this purpose, aggregate realized capital gains and losses, if any, equals the realized gain or loss calculated by the difference between the sales price of the property, less any costs to sell the property and the current gross value of the property (which is calculated as the original acquisition price plus any subsequent non-reimbursed capital improvements). At the end of the fiscal year, if this number is positive, then the capital gain fee payable for such time period shall equal 15.0% of such amount. No capital gain fee was recognized during the three and six months ended June 30, 2016 or 2015.

Termination Fee

The Second Amended Advisory Agreement includes a termination fee whereby, in the event of our termination of the agreement without cause (with 120 days’ prior written notice and the vote of at least two-thirds of our independent directors), a termination fee would be payable to the Adviser equal to two times the sum of the average annual base management fee and incentive fee earned by the Adviser during the 24-month period prior to such termination. A termination fee is also payable if the Adviser terminates the agreement after the Company has defaulted and applicable cure periods have expired. The agreement may also be terminated for cause by us (with 30 days’ prior written notice and the vote of at least two-thirds of our independent directors), with no termination fee payable. Cause is defined in the agreement to include if the Adviser breaches any material provisions of the agreement, the bankruptcy or insolvency of the Adviser, dissolution of the Adviser and fraud or misappropriation of funds.

Administration Agreement

Pursuant to the Administration Agreement, we pay for our allocable portion of the Administrator’s expenses in performing services to us, including, but not limited to, rent and the salaries and benefits of its personnel, including our chief financial officer, treasurer, chief compliance officer, general counsel and secretary (who also serves as our Administrator’s president), and their respective staffs. Our allocable portion of the Administrator’s expenses is derived by multiplying our Administrator’s total expenses by the approximate percentage of time the Administrator’s employees perform services for us in relation to their time spent performing services for all companies serviced by our Administrator under contractual agreements. For the three and six months ended June 30, 2016, we recorded an administration fee of $0.4 million and $0.8 million, respectively, and for the three and six months ended June 30, 2015, we recorded an administration fee of $0.4 million and $0.7 million, respectively. Our Board of Directors generally reviews and considers approving or renewing the agreement with our Administrator each July.

Gladstone Securities

Gladstone Securities, LLC, or Gladstone Securities, is a privately held broker dealer registered with the Financial Industry Regulatory Authority and insured by the Securities Investor Protection Corporation. Gladstone Securities is an affiliate of ours, as its parent company is owned and controlled by Mr. David Gladstone, our chairman and chief executive officer. Mr. Gladstone also serves on the board of managers of Gladstone Securities.

Dealer Manager Agreement

In connection with the offering of our Senior Common Stock (see footnote 10, “Stockholders’ Equity,” for further details) we entered into a Dealer Manager Agreement, dated March 25, 2011, or the Dealer Manager Agreement, with Gladstone Securities pursuant to which Gladstone Securities agreed to act as our exclusive dealer manager in connection with the offering. The Dealer Manager Agreement terminated according to its terms on March 28, 2015, requiring us to write-off $0.1 million of deferred offering costs to general and administrative expense. Pursuant to the terms of the Dealer Manager Agreement, Gladstone Securities was entitled to receive a sales commission in the amount of 7.0% of the gross proceeds of the shares of Senior Common Stock sold, plus a dealer manager fee in the amount of 3.0% of the gross proceeds of the shares of Senior Common Stock sold. In addition, we agreed to indemnify Gladstone Securities against various liabilities, including certain liabilities arising under the federal securities laws. We made approximately $0.3 million of payments during the six months ended June 30, 2015, to Gladstone Securities pursuant to this agreement.

Table of Contents

Mortgage Financing Arrangement Agreement

We entered into an agreement with Gladstone Securities, effective June 18, 2013, for it to act as our non-exclusive agent to assist us with arranging mortgage financing for properties we own. In connection with this engagement, Gladstone Securities may from time to time solicit the interest of various commercial real estate lenders or recommend to us third party lenders offering credit products or packages that are responsive to our needs. We pay Gladstone Securities a financing fee in connection with the services it provides to us for securing mortgage financing on any of our properties. The amount of these financing fees, which are payable upon closing of the financing, are based on a percentage of the amount of the mortgage, generally ranging from 0.15% to a maximum of 1.0% of the mortgage obtained. The amount of the financing fees may be reduced or eliminated, as determined by us and Gladstone Securities, after taking into consideration various factors, including, but not limited to, the involvement of any third party brokers and market conditions. We paid financing fees to Gladstone Securities of $0.1 million and $0.1 million during the three and six months ended June 30, 2016, respectively, which are included in mortgage notes payable, net, in the condensed consolidated balance sheets, or 0.35% and 0.39% of total mortgages secured. We paid financing fees to Gladstone Securities of $0.1 million and $0.2 millions during the three and six months ended June 30, 2015, respectively, which are included in mortgage notes payable, net, in the condensed consolidated balance sheets, or 0.3% of total mortgages secured in each period. Our Board of Directors renewed the agreement for an additional year, through August 31, 2017, at its July 2016 meeting.

3. Loss per Share of Common Stock

The following tables set forth the computation of basic and diluted loss per share of common stock for the three and six months ended June 30, 2016 and 2015, respectively. We computed basic loss per share for the three and six months ended June 30, 2016 and 2015, respectively, using the weighted average number of shares outstanding during the periods. Diluted loss per share for the three and six months ended June 30, 2016 and 2015, reflects additional shares of common stock related to our convertible senior common stock (if the effect would be dilutive), that would have been outstanding if dilutive potential shares of common stock had been issued, as well as an adjustment to net income available to common stockholders as applicable to common stockholders that would result from their assumed issuance (dollars in thousands, except per share amounts).

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Calculation of basic loss per share of common stock:				
Net loss attributable to common stockholders	$(631)	$ (853)	$(1,056)	$ (1,407)
Denominator for basic weighted average shares of common stock	22,684,391	20,833,787	22,614,838	20,524,101
Basic loss per share of common stock	$(0.03)	$ (0.04)	$(0.05)	$ (0.07)
Calculation of diluted loss per share of common stock:				
Net loss attributable to common stockholders	$(631)	$ (853)	$(1,056)	$ (1,407)
Net loss attributable to common stockholders plus assumed conversions (1)	$(631)	$ (853)	$(1,056)	$ (1,407)
Denominator for basic weighted average shares of common stock	22,684,391	20,833,787	22,614,838	20,524,101
Effect of convertible senior common stock (1)	—	—	—	—
Denominator for diluted weighted average shares of common stock (1)	22,684,391	20,833,787	22,614,838	20,524,101
Diluted loss per share of common stock	$(0.03)	$ (0.04)	$(0.05)	$ (0.07)

(1) We excluded 800,116 shares of convertible senior common stock from the calculation of diluted earnings per share for the three and six months ended June 30, 2016, respectively, because it was anti-dilutive. We also excluded 830,600 shares and 775,002 shares of convertible senior common stock from the calculation of diluted earnings per share for the three and six months ended June 30, 2015, respectively, because it was anti-dilutive.

4. Real Estate and Intangible Assets

Real Estate

The following table sets forth the components of our investments in real estate as of June 30, 2016 and December 31, 2015 (dollars in thousands):

	June 30, 2016 (1)	December 31, 2015 (2)
Real estate:		
Land	$99,780	$97,117
Building	641,266	635,728
Tenant improvements	49,186	47,532
Accumulated depreciation	(122,827)	(112,243)
Real estate, net	$667,405	$668,134

(1) Does not include real estate held for sale as of June 30, 2016.
(2) Does not include real estate held for sale as of December 31, 2015.

Real estate depreciation expense on building and tenant improvements was $5.9 million and $11.8 million for the three and six months ended June 30, 2016, respectively, and $5.5 million and $10.7 million for the three and six months ended June 30, 2015, respectively.

2016 Real Estate Activity

During the six months ended June 30, 2016, we acquired one property, which is summarized below (dollars in thousands):

Location	Acquisition Date	Square Footage (unaudited)	Lease Term	Renewal Options	Total Purchase Price	Acquisition Expenses	Annualized GAAP Rent	Debt Issued
Salt Lake City, UT	5/26/2016	107,062	6 Years	2 (3 Years and 2 Years)	$ 17,000	$ 109	$ 1,393	$9,900

In accordance with Accounting Standards Codification, or ASC, 805, "Business Combinations," we determined the fair value of the acquired assets related to the one property acquired during the six months ended June 30, 2016 as follows (dollars in thousands):

Location	Land	Building	Tenant Improvements	In-place Leases	Leasing Costs	Customer Relationships	Below Market Leases	Total Purchase Price
Salt Lake City, UT	$3,008	$ 8,973	$ 1,685	$ 1,352	$ 337	$ 1,675	$ (30)	$ 17,000

Below is a summary of the total revenue and earnings recognized on the one property acquired during the six months ended June 30, 2016 (dollars in thousands):

Location	Acquisition Date	For the three months ended June 30, 2016		For the six months ended June 30, 2016	
		Rental Revenue	Earnings (1)	Rental Revenue	Earnings (1)

Salt Lake City, UT	5/26/2016	$139	$ 35	$139	$ 35

(1) Earnings is calculated as net income exclusive of both interest expense and acquisition related costs that are required to be expensed under ASC 805.

11

Table of Contents

Pro Forma

The following table reflects pro-forma consolidated statements of operations as if the properties acquired during the six months ended June 30, 2016 and the twelve months ended December 31, 2015, respectively, were acquired as of January 1, 2015. The pro-forma earnings for the six months ended June 30, 2016 and 2015 were adjusted to assume that the acquisition-related costs were incurred as of the previous period (dollars in thousands, except per share amounts):

	For the three months ended June 30, (unaudited)		For the six months ended June 30, (unaudited)	
	2016	2015	2016	2015
Operating Data:				
Total operating revenue	$21,465	$21,955	$43,349	$43,420
Total operating expenses	(13,485)	(13,382)	(27,005)	(26,037)
Other expenses	(7,004)	(8,024)	(14,540)	(15,993)
Net income	976	549	1,804	1,390
Dividends attributable to preferred and senior common stock	(1,514)	(1,284)	(2,794)	(2,532)
Net loss attributable to common stockholders	$(538)	$(735)	$(990)	$(1,142)
Share and Per Share Data:				
Basic and diluted loss per share of common stock - pro forma	$(0.02)	$(0.04)	$(0.04)	$(0.06)
Basic and diluted loss per share of common stock - actual	$(0.03)	$(0.04)	$(0.05)	$(0.07)
Weighted average shares outstanding-basic and diluted	22,684,391	20,833,787	22,614,838	20,524,101

Significant Real Estate Activity on Existing Assets

During the six months ended June 30, 2016, we executed leases on three properties, which are summarized below (dollars in thousands):

Location	Lease Commencement Date	Square Footage (unaudited)	Lease Term	Renewal Options	Annualized GAAP Rent	Tenant Improvement	Leasing Commissions
Maple Heights, OH	6/1/2016	40,606 (1)	5.2 Years	2 (3 year)	$ 109	$ —	$ 34
Bolingbrook, IL	7/1/2016	13,816 (2)	7.2 Years	1 (5 year)	70	69	28
Burnsville, MN	12/1/2016	12,663 (3)	5.3 Years	1 (5 year)	143	—	104

(1) Tenant's lease is for 11.7% of the building. The building is now 92.8% leased.
(2) Tenant’s lease is for 24.9% of the building. The building is now 62.7% leased.
(3) Tenant's lease is for 11.0% of the building. The building is now 80.4% leased.

On May 31, 2016, we reached a legal settlement with the previous tenant at our currently vacant Newburyport, Massachusetts property to compensate us for deferred capital obligations and repairs they were required to perform during their tenancy. We recognized $0.3 million, recorded in other income on the condensed consolidated statement of operations, related to reimbursed deferred capital obligations, and received $0.9 million as a reimbursement of repairs incurred during the three and six months ended June 30, 2016 in connection with the legal settlement received.

Table of Contents

2015 Real Estate Activity

Investment Activity

During the six months ended June 30, 2015, we acquired four properties, which are summarized below (dollars in thousands):

Location		Acquisition Date	Square Footage (unaudited)	Lease Term	Renewal Options	Total Purchase Price	Acquisition Expenses	Annualized GAAP Rent	Debt Issued
Richardson, TX	(1)	3/6/2015	155,984	9.5 Years	2 (5 years each)	$ 24,700	$ 112	$ 2,708	$ 14,573
Birmingham, AL		3/20/2015	30,850	8.5 Years	1 (5 years)	3,648	76	333	N/A
Columbus, OH		5/28/2015	78,033	15.0 Years	2 (5 years each)	7,700	72	637	4,466
Salt Lake City, UT	(1)	5/29/2015	86,409	6.5 Years	1 (5 years)	22,200	144	2,411	13,000
Total			351,276			$ 58,248	$ 404	$ 6,089	$ 32,039

(1) The tenant occupying this property is subject to a gross lease.

In accordance with ASC 805, we determined the fair value of the acquired assets and assumed liabilities related to the four properties acquired during the six months ended June 30, 2015, as follows (dollars in thousands):

Location	Land	Building	Tenant Improvements	In-place Leases	Leasing Costs	Customer Relationships	Above Market Leases	Below Market Leases	Total Purchase Price
Richardson, TX	$ 2,728	$ 12,591	$ 2,781	$ 2,060	$ 1,804	$ 1,929	$ 807	$—	$ 24,700
Birmingham, AL	650	1,683	351	458	146	360	—	—	3,648
Columbus, OH	1,338	3,511	1,547	1,144	672	567	—	(1,079)	7,700
Salt Lake City, UT	3,248	11,861	1,268	2,396	981	1,678	821	(53)	22,200
	$ 7,964	$ 29,646	$ 5,947	$ 6,058	$ 3,603	$ 4,534	$ 1,628	$ (1,132)	$ 58,248

Below is a summary of the total revenue and earnings recognized on the four properties acquired during the three and six months ended June 30, 2015 (dollars in thousands):

		For the three months ended June 30, 2015		For the six months ended June 30, 2015	
Location	Acquisition Date	Rental Revenue	Earnings (1)	Rental Revenue	Earnings (1)
Richardson, TX	3/6/2015	$ 657	$ 90	$ 839	$ 328
Birmingham, AL	3/20/2015	83	(22)	94	106
Columbus, OH	5/28/2015	67	149	67	149
Salt Lake City, UT	5/29/2015	207	278	207	278
		$ 1,014	$ 495	$ 1,207	$ 861

(1) Earnings is calculated as net income (loss) exclusive of both interest expense and acquisition related costs that are required to be expensed under ASC 805.

Table of Contents

Leasing Activity

During the six months ended June 30, 2015, we amended six of our leases, which are summarized below (dollars in thousands):

Location	New Lease Effective Date	Square Footage (unaudited)		New Lease Term	Renewal Options	Annualized GAAP Rent	Tenant Improvement	Leasing Commissions
Indianapolis, IN	1/1/2015	3,546		8.3 Years	N/A	$ 64	$ 64	$ 28
Indianapolis, IN	2/1/2015	8,275		3.0 Years	N/A	124	—	—
Raleigh, NC	2/1/2015	58,926		5.5 Years	2 (5 year)	711	—	144
Raleigh, NC	2/1/2015	21,300	(1)	5.5 Years	2 (5 year)	239	100	32
Columbus, OH	12/1/2016	9,484	(2)	7.1 Years	N/A	1,246	142	29
Raleigh, NC	8/1/2015	86,886	(3)	12.4 Years	2 (5 year)	534	800	398
		188,417				$ 2,918	$ 1,106	$ 631

(1) Tenant's lease is for 18.3% of the building. The building is now 93.2% leased.

(2) The anchor tenant currently occupying 92.0% of the building will expand into the remaining space, currently occupied by another tenant through November 30, 2016.

(3) Tenant's lease is for 74.8% of the building. The building is now 93.2% leased.

Intangible Assets

The following table summarizes the carrying value of intangible assets, liabilities and the accumulated amortization for each intangible asset and liability class as of June 30, 2016 and December 31, 2015 respectively (in thousands):

	June 30, 2016 (1)		December 31, 2015 (2)	
	Lease Intangibles	Accumulated Amortization	Lease Intangibles	Accumulated Amortization
In-place leases	$67,217	$ (25,428)	$66,244	$ (22,679)
Leasing costs	44,791	(16,748)	44,360	(14,774)
Customer relationships	48,099	(16,248)	46,485	(14,722)
	$160,107	$ (58,424)	$157,089	$ (52,175)
	Deferred Rent Receivable/(Liability)	Accumulated (Amortization)/Accretion	Deferred Rent Receivable/(Liability)	Accumulated (Amortization)/Accretion
Above market leases	$10,232	$ (7,053)	$10,176	$ (6,818)
Below market leases and deferred revenue	(17,302)	8,338	(17,951)	8,294
	$(7,070)	$ 1,285	$(7,775)	$ 1,476

(1) Does not include real estate held for sale as of June 30, 2016.

(2) Does not include real estate held for sale as of December 31, 2015.

Total amortization expense related to in-place leases, leasing costs and customer relationship lease intangible assets was $3.3 million and $6.6 million for the three and six months ended June 30, 2016, respectively, and $3.5 million and $6.4 million for the three and six months ended June 30, 2015, respectively, and is included in depreciation and amortization expense in the condensed consolidated statement of operations.

Total amortization related to above-market lease values was $0.1 million and $0.2 million for the three and six months ended June 30, 2016, respectively, and $0.1 million and $0.2 million for the three and six months ended June 30, 2015, respectively, and is included in rental income in the condensed consolidated statement of operations. Total amortization related to below-market lease values was $0.2 million and $0.5 million for the three and six months ended June 30, 2016, respectively, and $0.2 million and $0.5 million for the three and six months ended June 30, 2015, respectively, and is included in rental income in the condensed consolidated statement of operations.

Table of Contents

The weighted average amortization periods in years for the intangible assets acquired and liabilities assumed during the six months ended June 30, 2016 and 2015, respectively, were as follows:

Intangible Assets & Liabilities	2016	2015
In-place leases	6.1	10.9
Leasing costs	6.1	10.9
Customer relationships	9.1	15.6
Above market leases	0	18.9
Below market leases	6.1	12.4
All intangible assets & liabilities	6.9	12.5

5. Real Estate Dispositions, Held for Sale, and Impairment Charges

Real Estate Dispositions

On May 16, 2016, we completed the sale of our Dayton, Ohio property for $0.2 million. There was no gain or loss recognized on this sale. We considered this office asset to be non-core to our long term strategy, and we re-deployed the proceeds to pay down outstanding debt.

The table below summarizes the components of operating income from the real estate and related assets disposed of for the Dayton, Ohio property during the three and six months ended June 30, 2016, and 2015, respectively (dollars in thousands):

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Operating revenue	$1	$106	$45	$215
Operating expense	50	50	103	105
Other expense	—	(25)	(43)[(1)]	(49)
(Loss) income from real estate and related assets sold	$(49)	$31	$(101)	$61

(1) Includes $0.04 million impairment charge on our Dayton, Ohio property.

Real Estate Held for Sale

As of June 30, 2016, we classified one property located in Rock Falls, Illinois, two properties located in Angola, Indiana and one property located in Montgomery, Alabama, as held for sale under the provisions of ASC 360-10, "Property, Plant, and Equipment," which requires that the assets and liabilities of any such properties, be presented separately in our condensed consolidated balance sheet in the current period presented. We consider these industrial assets to be non-core to our long term strategy. We have executed sales agreements for each of these properties and anticipate completing these sales during third quarter 2016.

The table below summarizes the components of income from real estate and related assets held for sale (dollars in thousands):

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Operating revenue	$119	$212	$242	$424
Operating expense	29	65	57	131
Other expense	(200)(1)	(33)	(232)(1)	(65)
(Loss) income from real estate and related assets held for sale	$(110)	$114	$(47)	$228

(1) Includes $0.2 million impairment charge on our four properties held for sale.

Table of Contents

The table below summarizes the components of the assets and liabilities held for sale reflected on the accompanying condensed consolidated balance sheet (dollars in thousands):

	June 30, 2016
ASSETS HELD FOR SALE	
Real estate, at cost	$4,593
Less: accumulated depreciation	1,187
Total real estate held for sale, net	3,406
Lease intangibles, net	153
Deferred rent receivable, net	259
Other assets	2
TOTAL ASSETS HELD FOR SALE	$3,820
LIABILITIES HELD FOR SALE	
Deferred rent liability, net	$274
Asset retirement obligation	83
Other liabilities	—
TOTAL LIABILITIES HELD FOR SALE	$357

Impairment Charge

We performed an evaluation and analysis on our portfolio and determined that our Dayton, Ohio property was impaired during the three months ended March 31, 2016 by an additional $0.04 million. We sold this property for $0.2 million in May 2016, and did not recognize any gain or loss on the sale. This property was previously impaired by $0.6 million during fiscal year 2015.

We also recorded impairment charges of $0.2 million on our four properties classified as held for sale as of June 30, 2016.

The fair values for the above properties were calculated using Level 3 inputs which include an executed purchase and sale agreement and estimated selling costs.

No other impairment was recognized on our portfolio during both the three and six months ended June 30, 2016 and June 30, 2015, respectively.

6. Mortgage Note Receivable

On July 25, 2014, we closed a $5.6 million second mortgage development loan for the construction of an 81,371 square foot, build-to-suit transitional care facility located on a major hospital campus in Phoenix, Arizona. Subsequently, on April 14, 2015, we closed an additional $0.3 million interim financing loan for the development of the Phoenix, Arizona property. Construction was completed in July 2015 and we earned 9.0% interest, paid currently in cash, on the loan during construction and through maturity. Prior to completion of the facility, we were granted a right of first offer to purchase the property at fair value. We elected not to purchase the property, and received an exit fee upon maturity of the loan in an amount sufficient for us to earn an internal rate of return of 22% on the second mortgage development loan, inclusive of interest earned. We recognized $0.4 million in both cash interest income and exit fee revenue during the six months ended June 30, 2016. We recognized $0.3 million and $0.5 million, respectively, in both cash interest income and exit fee revenue during the three and six months ended June 30, 2015, respectively. The principal balance of the loans and all associated interest and exit fee revenue was received in January 2016. We currently have no mortgage notes receivable outstanding.

Table of Contents

7. Mortgage Notes Payable, Line of Credit and Term Loan Facility

Our mortgage notes payable and line of credit as of June 30, 2016 and December 31, 2015 are summarized below (dollars in thousands):

	Encumbered properties at		Carrying Value at		Stated Interest Rates at		Scheduled Maturity Dates at
	June 30, 2016		June 30, 2016	December 31, 2015	June 30, 2016	(4)	June 30, 2016
Mortgage and Other Secured Loans:							
Fixed rate mortgage loans	56		$385,760	$427,334	(1)		(2)
Variable rate mortgage loans	16		60,546	33,044	(3)		(2)
Premiums and discounts (net)	-		277	392	N/A		N/A
Deferred financing costs, mortgage loans (net)	-		(4,979)	(4,907)	N/A		N/A
Total Mortgage Notes Payable	72		$441,604	$455,863	(5)		
Variable rate Line of Credit	24	(6)	60,800	45,300	LIBOR + 2.50%		8/7/2018
Deferred financing costs, line of credit (net)	-		(571)	(709)	N/A		N/A
Total Line of Credit	24		$60,229	$44,591			
Variable rate Term Loan Facility	-		25,000	25,000	LIBOR + 2.45%		10/5/2020
Deferred financing costs, term loan facility (net)	-		(113)	(122)	N/A		N/A
Total Term Loan Facility	N/A		$24,887	$24,878			
Total Mortgage Notes Payable, Line of Credit and Term Loan Facility	96		$526,720	$525,332			

(1) Interest rates on our fixed rate mortgage notes payable vary from 3.75% to 6.63%.

(2) We have 42 mortgage notes payable with maturity dates ranging from 12/1/2016 through 7/1/2045.

(3) Interest rates on our variable rate mortgage notes payable vary from one month LIBOR + 2.15% to one month LIBOR + 2.75%. At June 30, 2016, one month LIBOR was approximately 0.47%.

(4) The weighted average interest rate on all debt outstanding at June 30, 2016, was approximately 4.47%.

(5) The weighted average interest rate on the mortgage notes outstanding at June 30, 2016, was approximately 4.77%.

(6) The amount we may draw under our line of credit and term loan facility is based on a percentage of the fair value of a combined pool of 24 unencumbered properties as of June 30, 2016.

N/A - Not Applicable

Mortgage Notes Payable

As of June 30, 2016, we had 42 mortgage notes payable, collateralized by a total of 72 properties with a net book value of $626.7 million. Gladstone Commercial Corporation has limited recourse liabilities that could result from any one or more of the following circumstances: a borrower voluntarily filing for bankruptcy, improper conveyance of a property, fraud or material misrepresentation, misapplication or misappropriation of rents, security deposits, insurance proceeds or condemnation proceeds, or physical waste or damage to the property resulting from a borrower's gross negligence or willful misconduct. Gladstone Commercial Corporation has full recourse for $3.4 million of the mortgages notes payable outstanding, or 0.8%. We will also indemnify lenders against claims resulting from the presence of hazardous substances or activity involving hazardous substances in violation of environmental laws on a property.

17

Table of Contents

During the six months ended June 30, 2016, we repaid 5 mortgages, collateralized by 11 properties and issued 3 long-term mortgages, collateralized by 8 properties, which are summarized below (dollars in thousands):

Date of Issuance/Repayment	Issuing Bank	Debt Issued	Interest Rate		Maturity Date	Principal Balance Repaid	Previous Interest Rate
3/1/2016	First Niagara Bank	$18,475	LIBOR + 2.35%	(1)	3/1/2023	$21,197	6.14%
4/22/2016	Great Southern Bank	9,530	LIBOR + 2.75%	(2)	4/22/2019	3,667	6.25%
4/28/2016	N/A	N/A	N/A	(3)	N/A	22,510	6.34%
5/26/2016	Prudential	9,900	4.684%	(4)	6/1/2026	N/A	N/A

(1) We refinanced maturing debt on our Chalfont, Pennsylvania, Big Flats, New York and Franklin and Eatontown, New Jersey properties, which was originally set to mature during second quarter 2016. We entered into an interest rate cap agreement with First Niagara Bank, which caps LIBOR at 3% through March 1, 2019.

(2) We refinanced maturing debt on our Coppell, Texas property, which was originally set to mature during second quarter 2016. We pooled the new mortgage debt with unencumbered properties located in Allen and Colleyville, Texas. We entered into an interest rate cap agreement with Great Southern Bank, which caps LIBOR at 2.5% through April 22, 2019.

(3) We repaid our $10.7 million mortgage on our Springfield, Missouri property that was originally set to mature on July 1, 2016, and we repaid our $11.8 million mortgage on our Wichita, Kansas, Clintonville, Wisconsin, Angola, Indiana and Rock Falls, Illinois properties that was originally set to mature on May 5, 2016. We repaid both mortgages using existing cash on hand and borrowings from our line of credit.

(4) We borrowed $9.9 million to acquire the property acquired in Salt Lake City, UT on May 26, 2016.

We made payments of $0.3 million and $0.7 million for deferred financing costs during the three and six months ended June 30, 2016, respectively, and payments of $0.4 million and $0.9 million during the three and six months ended June 30, 2015, respectively.

Scheduled principal payments of mortgage notes payable for the remainder of 2016, and each of the five succeeding fiscal years and thereafter are as follows (dollars in thousands):

Year	Scheduled Principal Payments	
Six Months Ending December 31, 2016	$25,303	
2017	70,115	
2018	42,027	
2019	45,463	
2020	11,910	
2021	24,121	
Thereafter	227,367	
Total	$446,306	(1)

(1) This figure does not include $0.3 million of premiums and (discounts) net and $5.7 million of deferred financing costs net, which are reflected in mortgage notes payable on the consolidated balance sheet.

Table of Contents

Interest Rate Cap

We have entered into interest rate cap agreements that cap the interest rate on certain of our notes payable when one-month LIBOR is in excess of 3.0%. We have adopted the fair value measurement provisions for our financial instruments recorded at fair value. The fair value guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. Generally, we will estimate the fair value of our interest rate caps, in the absence of observable market data, using estimates of value including estimated remaining life, counterparty credit risk, current market yield and interest rate spreads of similar securities as of the measurement date. At June 30, 2016 and December 31, 2015, our interest rate cap agreements were valued using Level 2 inputs.

The fair value of the interest rate cap agreements is recorded in other assets on our accompanying condensed consolidated balance sheets. We record changes in the fair value of the interest rate cap agreements quarterly based on the current market valuations at quarter end as interest expense on our accompanying condensed consolidated statements of operations. The following table summarizes the key terms of each interest rate cap agreement (dollars in thousands):

				As of June 30, 2016		As of December 31, 2015	
Interest Rate Cap	LIBOR Cap	Maturity Date	Cost	Notional Amount	Fair Value	Notional Amount	Fair Value
Nov-13	3.00%	Dec-16	$31	$8,200	$ —	$8,200	$ —
Jul-15	3.00%	Jul-18	68	20,874	—	21,204	14
Dec-15	3.00%	Dec-20	52	3,596	6	3,640	26
Mar-16	3.00%	Mar-19	33	18,367	3	—	—
Apr-16	2.50%	Apr-19	27	9,508	2	—	—
			$211	$60,545	$ 11	$33,044	$ 40

The fair value of all mortgage notes payable outstanding as of June 30, 2016 was $454.1 million, as compared to the carrying value stated above, inclusive of premiums, discounts and deferred financing costs, of $441.6 million. The fair value is calculated based on a discounted cash flow analysis, using management’s estimate of market interest rates on long-term debt with comparable terms and loan to value ratios. The fair value was calculated using Level 3 inputs of the hierarchy established by ASC 820, “Fair Value Measurements and Disclosures.”

Line of Credit and Term Loan Facility

In August 2013, we procured a senior unsecured revolving credit facility, or the Line of Credit, with KeyBank National Association (serving as a revolving lender, a letter of credit issuer and an administrative agent). On October 5, 2015, we expanded our Line of Credit to $85.0 million, extended the maturity date one-year through August 2018, with a one year extension option through August 2019 and entered into a Term Loan Facility (discussed below). The interest rate on the Line of Credit was also reduced by 25 basis points at each of the leverage tiers and the total maximum commitment under the two facilities, including the Line of Credit and Term Loan Facility, was increased from $100.0 million to $150.0 million. We also added three new lenders to the bank syndicate, which is now comprised of KeyBank, Comerica Bank, Fifth Third Bank, US Bank and Huntington Bank. We were subject to payment of $0.5 million for the modification of the agreement.

In connection with the Line of Credit expansion in October 2015 mentioned above, we added a $25.0 million, five year term loan facility, or the Term Loan Facility, which was fully drawn at closing and matures in October 2020. The Term Loan Facility is subject to the same leverage tiers as the Line of Credit; however the interest rate at each leverage tier is five basis points lower. We have the option to repay the Term Loan Facility in full, or in part, at any time without penalty or premium prior to the maturity date.

As of June 30, 2016, there was $85.8 million outstanding under our Line of Credit and Term Loan Facility at a weighted average interest rate of approximately 2.95% and $2.5 million outstanding under letters of credit at a weighted average interest rate of 2.5%. As of June 30, 2016, the maximum additional amount we could draw under the Line of Credit was $8.6 million. We were in compliance with all covenants under the Line of Credit and Term Loan Facility as of June 30, 2016.

The amount outstanding under the Line of Credit and Term Loan Facility approximates fair value as of June 30, 2016, as the debt is variable rate.

Table of Contents

8. Mandatorily Redeemable Preferred Stock

In February 2012, we completed a public offering of 1,540,000 shares of 7.125% Series C Cumulative Term Preferred Stock, par value $0.001 per share, or the Term Preferred Stock, at a public offering price of $25.00 per share. Gross proceeds of the offering totaled $38.5 million and net proceeds, after deducting offering expenses borne by us, were $36.7 million. The Term Preferred Stock is traded under the ticker symbol GOODN on the NASDAQ Global Select Market, or the NASDAQ. The Term Preferred Stock is not convertible into our common stock or any other security of ours. As of January 31, 2016, we may redeem the shares at a redemption price of $25.00 per share, plus any accumulated and unpaid dividends to and including the date of redemption. The shares of the Term Preferred Stock have a mandatory redemption date of January 31, 2017. We incurred $1.8 million in total offering costs related to these transactions, which have been recorded net of the Series C mandatorily redeemable preferred stock on the condensed consolidated balance sheet and will be amortized over the redemption period, ending August 19, 2016, see Note 11 for further information regarding the redemption of the Term Preferred Stock.

The Term Preferred Stock is recorded as a liability in accordance with ASC 480, "Distinguishing Liabilities from Equity," which states that mandatorily redeemable financial instruments should be classified as liabilities and therefore the related dividend payments are treated as a component of interest expense in the condensed consolidated statements of operations.

During June 2016, we partially redeemed $25.0 million of our Term Preferred Stock and accordingly wrote-off $0.1 million of unamortized offering costs, which were recorded to interest expense in our condensed consolidated statements of operations.

Subsequent to the second quarter, we sent notices of redemption for the remaining 540,000 shares outstanding of our Term Preferred Stock. We intend to redeem these shares on August 19, 2016 at a redemption price of $25.00 per share, plus an amount equal to all accumulated and unpaid dividends.

The fair value of our Term Preferred Stock as of June 30, 2016, was $13.6 million, as compared to the carrying value of $13.4 million, which includes $0.1 million of unamortized deferred financing costs. The fair value is calculated based on the closing share price as of June 30, 2016 of $25.20. The fair value was calculated using Level 1 inputs of the hierarchy established by ASC 820, "Fair Value Measurements and Disclosures."

9. Commitments and Contingencies

Ground Leases

We are obligated as lessee under four ground leases. Future minimum rental payments due under the terms of these leases as of June 30, 2016, are as follows (dollars in thousands):

		For the year ended December 31,					
Location	Lease End Date	2016	2017	2018	2019	2020	Thereafter
Tulsa, OK	Apr-21	$85	$169	$169	$169	$169	$ 85
Springfield, MA	Feb-30	43	89	90	90	90	884
Dartmouth, MA	May-36	87	174	174	174	174	3,126
Salt Lake City, UT	Nov-40	15	30	31	32	33	853
		$230	$462	$464	$465	$466	$ 4,948

Expenses recorded in connection to rental expense incurred for the properties listed above during both the three and six months ended June 30, 2016 and 2015 were $0.1 million and $0.2 million, respectively. Rental expenses are reflected in property operating expenses on the condensed consolidated statements of operations.

Letters of Credit

As of June 30, 2016, there was $2.5 million outstanding under letters of credit. These letters of credit are not reflected on our consolidated balance sheet.

Table of Contents

10. Stockholders’ and Mezzanine Equity

Stockholders' Equity

The following table summarizes the changes in our stockholders’ equity for the six months ended June 30, 2016 (dollars in thousands):

	Shares Issued and Retired								
	Preferred Stock Series A and B	Common Stock	Senior Common Stock	Preferred Stock Series A and B	Senior Common Stock	Common Stock	Additional Paid in Capital	Distributions in Excess of Accumulated Earnings	Total Stockholders' Equity
Balance at December 31, 2015	2,150,000	22,485,607	972,214	$ 2	$ 1	$ 22	$418,897	$(185,051)	$233,871
Issuance of preferred stock series A and B and common stock, net	114,000	497,997	—	—	—	1	10,889	—	10,890
Retirement of senior common stock	—	—	(12,662)	—	—	—	(178)	—	(178)
Distributions declared to common, senior common and preferred stockholders	—	—	—	—	—	—	—	(19,766)	(19,766)
Net income	—	—	—	—	—	—	—	1,738	1,738
Balance at June 30, 2016	2,264,000	22,983,604	959,552	$ 2	$ 1	$ 23	$429,608	$(203,079)	$226,555

Distributions

We paid the following distributions per share for the three and six months ended June 30, 2016 and 2015:

	For the three months ended June 30,		For the six months ended June 30,	
	2016	2015	2016	2015
Common Stock	$0.375	$ 0.375	$0.750	$ 0.750
Senior Common Stock	0.2625	0.2625	0.5250	0.5250
Series A Preferred Stock	0.4843749	0.4843749	0.9687498	0.9687498
Series B Preferred Stock	0.4688	0.4688	0.9375	0.9375
Series C Preferred Stock	0.4453	0.4453	0.8906	0.8906
Series D Preferred Stock	0.1788	—	0.1788	—

Recent Activity

Common Stock ATM Program

We sold 65,000 shares of common stock, raising $0.9 million in net proceeds under our previous ATM Program with Cantor Fitzgerald & Co., or Cantor Fitzgerald. In February 2016, we amended our common ATM program, or the Amended Common ATM, with Cantor Fitzgerald. The amendment increased the amount of shares of common stock that we may offer and sell through Cantor Fitzgerald, to $160.0 million. During the six months ended June 30, 2016, we sold 433,000 shares of common stock, raising $7.2 million in net proceeds under our Amended Common ATM. All other terms of the common ATM program remained unchanged. As of June 30, 2016, we had a remaining capacity to sell up to $151.8 million of common stock under the Amended Common ATM.

Table of Contents

Preferred Stock ATM Programs

Series A and B Preferred Stock: In February 2016, we entered into an open market sales agreement, or the Series A and B Preferred ATM, with Cantor Fitzgerald, pursuant to which we may, from time to time, offer to sell (i) shares of our 7.75% Series A Cumulative Redeemable Preferred Stock, and (ii) shares of our 7.50% Series B Cumulative Redeemable Preferred Stock, having an aggregate offering price of up to $40.0 million, through Cantor Fitzgerald, acting as sales agent and/or principal. During the six months ended June 30, 2016, we sold 114,000 shares of our Series B Cumulative Redeemable Preferred Stock for net proceeds of $2.8 million. As of June 30, 2016, we had a remaining capacity to sell up to $37.2 million of preferred stock under the Series A and B Preferred ATM.

Mezzanine Equity

Series D Preferred Stock: In May 2016, we entered into purchase agreements with certain institutional investors and broker dealers whereby we agreed to sell a total of 1,043,725 shares of our newly created 7.00% Series D Cumulative Redeemable Preferred Stock, or the Series D Preferred, par value $0.001 per share, with a liquidation preference of $25.00 per share, in a registered direct placement at a purchase price of $25.00 per share. Our total net proceeds from the offering, after deducting offering expenses, were $25.3 million. The proceeds from the Series D Preferred were used to redeem $25.0 million of our Term Preferred Stock. The Series D Preferred is classified as mezzanine equity in our condensed consolidated balance sheet because it is redeemable at the option of the shareholder upon a change of control of greater than 50% in accordance with ASC 480-10-S99 "Distinguishing Liabilities from Equity," which requires mezzanine equity classification for preferred stock issuances with redemption features which are outside of the control of the issuer. We will periodically evaluate the likelihood that a change of control greater than 50% will take place, and if we deem this probable, we would adjust the Series D Preferred presented in mezzanine equity to their redemption value , with the offset to gain(loss) on extinguishment. We currently believe the likelihood of a change of control greater than 50% is remote.

Series D Preferred Stock ATM: In June 2016, we entered into an open market sales agreement, or the Series D Preferred ATM, with Cantor Fitzgerald, pursuant to which we may, from time to time, offer to sell shares of our Series D Preferred, having an aggregate offering price of up to $50.0 million, through Cantor Fitzgerald, acting as sales agent and/or principal. During the six months ended June 30, 2016, we sold 20,000 shares of our Series D Preferred for net proceeds of $0.5 million. As of June 30, 2016, we had a remaining capacity to sell up to $49.5 million of Series D Preferred under the Series D Preferred ATM.

11. Subsequent Events

On July 12, 2016, our Board of Directors declared the following monthly distributions for the months of July, August and September:

Record Date	Payment Date	Common Stock Distributions per Share	Series A Preferred Distributions per Share	Series B Preferred Distributions per Share	Series C Preferred Distributions per Share (1)	Series D Preferred Distributions per Share
July 22, 2016	August 2, 2016	$ 0.125	$ 0.1614583	$ 0.15625	$ 0.1484375	$ 0.1458333
August 22, 2016	August 31, 2016	0.125	0.1614583	0.15625	—	0.1458333
September 21, 2016	September 30, 2016	0.125	0.1614583	0.15625	—	0.1458333
Total		$ 0.375	$ 0.4843749	$ 0.46875	$ 0.1484375	$ 0.4374999

(1) On July 12, 2016, we sent notices of redemption for the remaining 540,000 shares outstanding of our Series C Preferred Stock. We intend to redeem these shares on August 19, 2016 at a redemption price of $25.00 per share, plus an amount equal to all accumulated and unpaid dividends.

Senior Common Stock Distributions

Payable to the Holders of Record During the Month of:	Payment Date	Distribution per Share
July		$ 0.0875

	August 5, 2016	
August	September 8, 2016	0.0875
September	October 7, 2016	0.0875
Total		$ 0.2625

22

Table of Contents

On July 12, 2016, we amended and restated our existing advisory agreement with our Adviser to redefine the definition of adjusted stockholders' equity, by entering into a third amended and restated advisory agreement, to include total mezzanine equity in the calculation of both the base management and incentive fee. All other provisions remained unchanged. The amended definition is effective as of July 1, 2016.

Table of Contents

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

All statements contained herein, other than historical facts, may constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements may relate to, among other things, future events or our future performance or financial condition. In some cases, you can identify forward-looking statements by terminology such as "may," "might," "believe," "will," "provided," "anticipate," "future," "could," "growth," "plan," "intend," "expect," "s "seek," "possible," "potential," "likely" or the negative of such terms or comparable terminology. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our business, financial condition, liquidity, results of operations, funds from operations or prospects to be materially different from any future business, financial condition, liquidity, results of operations, funds from operations or prospects expressed or implied by such forward-looking statements. For further information about these and other factors that could affect our future results, please see the captions titled "Forward-Looking Statements" and "Risk Factors" in this report and in our Annual Report on Form 10-K for the year ended December 31, 2015. We caution readers not to place undue reliance on any such forward-looking statements, which are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this Quarterly Report on Form 10-Q.

All references to "we," "our," "us" and the "Company" in this Report mean Gladstone Commercial Corporation and its consolidated subsidiaries, except where the context indicates that the term means only Gladstone Commercial Corporation.

General

We are an externally-advised real estate investment trust, or REIT, that was incorporated under the General Corporation Law of the State of Maryland on February 14, 2003. We focus on acquiring, owning, and managing primarily office and industrial properties. On a selective basis, we may make long term industrial and commercial mortgage loans. Our properties are geographically diversified and our tenants cover a broad cross section of business sectors and range in size from small to very large private and public companies. We actively communicate with buyout funds, real estate brokers and other third parties to locate properties for potential acquisition or to provide mortgage financing in an effort to build our portfolio. We target secondary growth markets that possess favorable economic growth trends, diversified industries, and growing population and employment.

We have historically entered into, and intend in the future to enter into, purchase agreements for real estate having net leases with terms of approximately 7 to 15 years and built in rental rate increases. Under a net lease, the tenant is required to pay all operating, maintenance, repair and insurance costs and real estate taxes with respect to the leased property.

As of July 25, 2016:

- we owned 99 properties totaling 11.1 million square feet in 24 states;
- our occupancy rate was 98.5%;
- the weighted average remaining term of our mortgage debt was 6.4 years and the weighted average interest rate was 4.77%; and
- the average remaining lease term of the portfolio was 8.1 years.

Business Environment

In the United States, vacancy rates have decreased for both office and industrial properties in most markets, as increased user demand has led to improved conditions. In fact, vacancy rates in many markets have been reduced to levels seen at the peak before the most recent recession and rental rates have increased in many primary and secondary markets. This condition has led to a rise in construction activity for both office and industrial properties in many markets; however, vacancy rates in certain secondary and tertiary markets are still higher than pre-recession levels as job growth has yet to return to all areas of the country even though the published unemployment rate has dropped over the past 12 months. Interest rates have been volatile since the beginning of the year and although interest rates are still relatively low, lenders have increased their required spreads and overall financing costs for fixed rate mortgages appear to be on the rise. The combined characteristics of lower vacancy rates, increased supply of capital from private and foreign buyers, and a potential rise in financing costs has led to increased competition for new acquisitions.

Table of Contents

From a more macro-economic perspective, the strength of the global economy and U.S. economy in particular continue to be uncertain with increased volatility due to the recent vote in the United Kingdom to exit the European Union, the oversupply of energy worldwide and an apparent global economic slowdown. In addition, the uncertainty surrounding the ability of the federal government to address its fiscal condition in both the near and long term as well as other geo-political issues has increased domestic and global instability. These developments could cause interest rates and borrowing costs to rise, which may adversely affect our ability to access both the equity and debt markets and could have an adverse effect on our tenants as well.

We continue to focus on re-leasing vacant space, renewing upcoming lease maturities and acquiring additional properties. Currently, we only have one fully vacant building, which is located in Newburyport, Massachusetts, and a total of five partially vacant buildings.

We have one expiring lease in 2016, which accounts for 0.1% of rental income recognized during the six months ended June 30, 2016, six expiring leases in 2017, which accounts for 2.3% of rental income recognized during the six months ended June 30, 2016 and three expiring leases in 2018, which accounts for 1.9% of rental income recognized during the six months ended June 30, 2016.

Our available vacant space at June 30, 2016 represents 1.5% of our total square footage and the annual carrying costs on the vacant space, including real estate taxes and property operating expenses, are approximately $0.9 million. We continue to actively seek new tenants for these properties.

Our ability to make new investments is highly dependent upon our ability to procure external financing. Our principal sources of external financing generally include the issuance of equity securities, long-term mortgage loans secured by properties and borrowings under our line of credit, or the Line of Credit. While lenders' credit standards have tightened, long-term mortgages are readily obtainable. We continue to look to regional banks and insurance companies, in addition to the collateralized mortgage backed securities market, or the CMBS market, to issue mortgages to finance our real estate activities.

In addition to obtaining funds through borrowing, we have been active in the equity markets during the six months ended June 30, 2016. We have issued shares of both common and preferred stock through our at-the-market programs, or ATM Programs, pursuant to our open market sale agreements with Cantor Fitzgerald, discussed in more detail below.

Recent Developments

2016 Investment Activity

During the six months ended June 30, 2016, we acquired one property, which is summarized below (dollars in thousands):

Location	Acquisition Date	Square Footage (unaudited)	Lease Term	Renewal Options	Total Purchase Price	Acquisition Expenses	Annualized GAAP Rent	Debt Issued
Salt Lake City, UT	5/26/2016	107,062	6 Years	2 (3 Years and 2 Years)	$ 17,000	$ 109	$ 1,393	$9,900

Table of Contents

2016 Financing Activity

During the six months ended June 30, 2016, we repaid 5 mortgages, collateralized by 11 properties and issued 3 long-term mortgages, collateralized by 8 properties, which are summarized below (dollars in thousands):

Date of Issuance/Repayment	Issuing Bank	Debt Issued	Interest Rate		Maturity Date	Principal Balance Repaid	Previous Interest Rate
3/1/2016	First Niagara Bank	$18,475	LIBOR + 2.35%	(1)	3/1/2023	$21,197	6.14%
4/22/2016	Great Southern Bank	9,530	LIBOR + 2.75%	(2)	4/22/2019	3,667	6.25%
4/28/2016	N/A	N/A	N/A	(3)	N/A	22,510	6.34%
5/26/2016	Prudential	9,900	4.684%	(4)	6/1/2026	N/A	N/A

(1) We refinanced maturing debt on our Chalfont, Pennsylvania, Corning, New York and Franklin and Eatontown, New Jersey properties, which was originally set to mature during second quarter 2016. We entered into an interest rate cap agreement with First Niagara Bank, which caps LIBOR at 3% through March 1, 2019.

(2) We refinanced maturing debt on our Coppell, Texas property, which was originally set to mature during second quarter 2016. We pooled the new mortgage debt with unencumbered properties located in Allen and Colleyville, Texas. We entered into an interest rate cap agreement with Great Southern Bank, which caps LIBOR at 2.5% through April 22, 2019.

(3) Through a wholly-owned subsidiary, we repaid our $10.7 million mortgage on our Springfield, Missouri property, that was originally set to mature on July 1, 2016, and we repaid our $11.8 million mortgage on our Wichita, Kansas, Clintonville, Wisconsin, Angola, Indiana and Rock Falls, Illinois properties that was originally set to mature on May 5, 2016. We repaid both mortgages using existing cash on hand and borrowings from our line of credit.

(4) Through a wholly-owned subsidiary, we borrowed $9.9 million to acquire the property acquired in Salt Lake City, UT on May 26, 2016.

2016 Leasing Activities

We have executed leases on three properties, which are summarized below (dollars in thousands):

Location	Lease Commencement Date	Square Footage (unaudited)		Lease Term	Renewal Options	Annualized GAAP Rent	Tenant Improvement	Leasing Commissions
Maple Heights, OH	6/1/2016	40,606	(1)	5.2 Years	2 (3 year)	$ 109	$ —	$ 34
Bolingbrook, IL	7/1/2016	13,816	(2)	7.2 Years	1 (5 year)	$ 70	$ 69	$ 28
Burnsville, MN	12/1/2016	12,663	(3)	5.3 Years	1 (5 year)	$ 143	$ —	$ 104

(1) Tenant's lease is for 11.7% of the building. The building is now 92.8% leased.
(2) Tenant’s lease is for 24.9% of the building. The building is now 62.7% leased.
(3) Tenant's lease is for 11.0% of the building. The building is now 80.4% leased.

2016 Equity Activities

Series D Preferred Stock Offering: In May 2016, we entered into purchase agreements with certain institutional investors and broker dealers whereby we agreed to sell a total of 1,043,725 shares of our newly created 7.00% Series D Cumulative Redeemable Preferred Stock, or the Series D Preferred, par value $0.001 per share, with a liquidation preference of $25.00 per share, in a registered direct placement at a purchase price of $25.00 per share. Our total net proceeds from the offering, after deducting offering expenses, were $25.3 million.

Table of Contents

Common Stock ATM Program: We sold 65,000 shares of common stock, raising $0.9 million in net proceeds under our previous ATM Program with Cantor Fitzgerald. In February 2016, we amended our common ATM program, or the Amended Common ATM, with Cantor Fitzgerald. The amendment increased the amount of shares of common stock that we may offer and sell through Cantor Fitzgerald, to $160.0 million. During the six months ended June 30, 2016, we sold 433,000 shares of common stock, raising $7.2 million in net proceeds under our Amended Common ATM. All other terms of the common ATM program remained unchanged. As of June 30, 2016, we had a remaining capacity to sell up to $151.8 million of common stock under the Amended Common ATM.

Preferred ATM Programs:

Series A and B Preferred Stock: In February 2016, we entered into an open market sales agreement, or the Series A and B Preferred ATM, with Cantor Fitzgerald, pursuant to which we may, from time to time, offer to sell (i) shares of our 7.75% Series A Cumulative Redeemable Preferred Stock, and (ii) shares of our 7.50% Series B Cumulative Redeemable Preferred Stock, having an aggregate offering price of up to $40.0 million, through Cantor Fitzgerald, acting as sales agent and/or principal. During the six months ended June 30, 2016, we sold 114,000 shares of our Series B Cumulative Redeemable Preferred Stock for net proceeds of $2.8 million. As of June 30, 2016, we had a remaining capacity to sell up to $37.2 million of preferred stock under the Series A and B Preferred ATM.

Series D Preferred Stock: In June 2016, we entered into an open market sales agreement, or the Series D Preferred ATM, with Cantor Fitzgerald, pursuant to which we may, from time to time, offer to sell shares of our Series D Preferred, having an aggregate offering price of up to $50.0 million, through Cantor Fitzgerald, acting as sales agent and/or principal. During the six months ended June 30, 2016, we sold 20,000 shares of our Series D Preferred for net proceeds of $0.5 million. As of June 30, 2016, we had a remaining capacity to sell up to $49.5 million of Series D Preferred under the Series D Preferred ATM.

Series C Preferred Stock Redemption:

During June 2016, we partially redeemed $25.0 million of our 7.125% Series C Cumulative Term Preferred Stock, or Term Preferred Stock, that was originally set to mature in January 2017. On July 12, 2016, we sent notices of redemption for the remaining 540,000 shares outstanding of our Term Preferred Stock. We intend to redeem these shares on August 19, 2016 at a redemption price of $25.00 per share, plus an amount equal to all accumulated and unpaid dividends.

Table of Contents

Diversity of Our Portfolio

Our Adviser seeks to diversify our portfolio to avoid dependence on any one particular tenant, industry or geographic market. By diversifying our portfolio, our Adviser intends to reduce the adverse effect on our portfolio of a single under-performing investment or a downturn in any particular industry or geographic market. For the six months ended June 30, 2016, our largest tenant comprised only 5.8% of total rental income. The table below reflects the breakdown of our total rental income by tenant industry classification for the three and six months ended June 30, 2016 and 2015, respectively (dollars in thousands):

	For the three months ended June 30,				For the six months ended June 30,			
	2016		2015		2016		2015	
Industry Classification	Rental Income	Percentage of Rental Income	Rental Income	Percentage of Rental Income	Rental Income	Percentage of Rental Income	Rental Income	Percentage of Rental Income
Healthcare	$3,438	16.5 %	$3,187	15.9 %	$6,786	16.3 %	$5,828	14.8 %
Telecommunications	3,280	15.7	3,200	16.1	6,561	15.8	6,329	16.3
Automobile	2,639	12.6	2,635	13.2	5,267	12.7	5,270	13.4
Diversified/Conglomerate Services	1,970	9.4	1,170	5.8	3,939	9.5	2,337	5.9
Diversified/Conglomerate Manufacturing	1,149	5.5	1,010	5.0	2,299	5.5	2,053	5.2
Electronics	1,082	5.2	1,202	6.0	2,165	5.2	2,402	6.1
Personal, Food & Miscellaneous Services	892	4.3	1,576	7.9	1,785	4.3	3,153	8.0
Chemicals, Plastics & Rubber	779	3.7	789	3.9	1,561	3.8	1,578	4.0
Information Technology	727	3.5	207	1.0	1,315	3.2	207	0.5
Machinery	679	3.3	772	3.9	1,362	3.3	1,544	3.9
Containers, Packaging & Glass	672	3.2	521	2.6	1,337	3.2	1,042	2.7
Personal & Non-Durable Consumer Products	656	3.1	657	3.3	1,313	3.2	1,316	3.3
Banking	612	2.9	289	1.4	1,225	2.9	578	1.5
Childcare	556	2.7	556	2.8	1,112	2.7	1,112	2.8
Buildings and Real Estate	548	2.6	548	2.7	1,095	2.6	1,095	2.8
Beverage, Food & Tobacco	525	2.5	679	3.4	1,051	2.5	1,427	3.6
Printing & Publishing	390	1.9	391	2.0	781	1.9	782	2.0
Education	164	0.8	164	0.8	328	0.8	328	0.8
Home & Office Furnishings	132	0.6	132	0.7	265	0.6	265	0.7
Oil & Gas	—	—	327	1.6	—	—	654	1.7
	$20,890	100.0 %	$20,012	100.0 %	$41,547	100.0 %	$39,300	100.0 %

Table of Contents

The table below reflects the breakdown of total rental income by state for the three and six months ended June 30, 2016 and 2015, respectively (dollars in thousands):

State	Rental Revenue for the three months ended June 30, 2016	% of Base Rent	Number of Leases for the three months ended June 30, 2016	Rental Revenue for the three months ended June 30, 2015	% of Base Rent	Number of Leases for the three months ended June 30, 2015
Texas	$ 3,722	17.8 %	12	$ 3,686	18.4 %	11
Ohio	2,429	11.6	16	2,563	12.8	17
Pennsylvania	1,678	8.0	6	1,655	8.3	6
North Carolina	1,441	6.9	8	1,308	6.5	7
Georgia	1,192	5.7	6	718	3.6	3
South Carolina	1,153	5.5	2	1,115	5.6	2
Michigan	1,074	5.1	4	1,074	5.4	4
Minnesota	845	4.0	4	819	4.1	3
Colorado	813	3.9	3	813	4.1	3
New Jersey	798	3.8	4	798	4.0	4
All Other States	5,745	27.7	34	5,463	27.3	34
Total	$ 20,890	100.0 %	99	$ 20,012	100.0 %	94

State	Rental Revenue for the six months ended June 30, 2016	% of Base Rent	Number of Leases for the six months ended June 30, 2016	Rental Revenue for the six months ended June 30, 2015	% of Base Rent	Number of Leases for the six months ended June 30, 2015
Texas	$ 7,432	17.9 %	12	$ 6,896	17.5 %	11
Ohio	4,767	11.5	16	5,052	12.9	17
Pennsylvania	3,358	8.1	6	3,312	8.4	6
North Carolina	2,881	6.9	8	2,646	6.7	7
Georgia	2,384	5.7	6	1,437	3.7	3
South Carolina	2,306	5.6	2	2,231	5.7	2
Michigan	2,147	5.2	4	2,147	5.5	4
Minnesota	1,689	4.1	4	1,637	4.2	3
Colorado	1,626	3.9	3	1,626	4.1	3
New Jersey	1,599	3.8	4	1,598	4.1	4
All Other States	11,358	27.3	34	10,718	27.3	34
Total	$ 41,547	100.0 %	99	$ 39,300	100.0 %	94

Our Adviser and Administrator

Our Adviser is led by a management team with extensive experience purchasing real estate and originating mortgage loans. Our Adviser and Administrator are controlled by Mr. David Gladstone, who is also our chairman and chief executive officer. Mr. Gladstone also serves as the chairman and chief executive officer of both our Adviser and Administrator. Mr. Terry Lee Brubaker, our vice chairman and chief operating officer, is also the vice chairman and chief operating officer of our Adviser and Administrator. Mr. Robert Cutlip, our president, is also an executive managing director of our Adviser. Gladstone Administration, LLC, or our Administrator, employs our chief financial officer, treasurer, chief compliance officer, general counsel and secretary (who also serves as our Administrator's president) and their respective staffs.

Table of Contents

Our Adviser and Administrator also provide investment advisory and administrative services, respectively, to certain of our affiliates, including, but not limited to, Gladstone Capital Corporation and Gladstone Investment Corporation, both publicly-traded business development companies, as well as Gladstone Land Corporation, a publicly-traded REIT that primarily invests in farmland. With the exception of Ms. Danielle Jones, our chief financial officer, Mr. Jay Beckhorn, our treasurer, and Mr. Robert Cutlip, our president, all of our executive officers and all of our directors serve as either directors or executive officers, or both, of Gladstone Capital Corporation and Gladstone Investment Corporation. In addition, with the exception of Mr. Cutlip and Ms. Jones, all of our executive officers and all of our directors, serve as either directors or executive officers, or both, of Gladstone Land Corporation. In the future, our Adviser may provide investment advisory services to other companies, both public and private.

Advisory and Administration Agreements

We are externally managed pursuant to contractual arrangements with our Adviser and our Administrator. Our Adviser and Administrator employ all of our personnel and pay their payroll, benefits and general expenses directly. We have an investment advisory agreement with our Adviser, and an administration agreement with our Administrator, or the Administration Agreement.

Under the terms of the advisory agreement, we are responsible for all expenses incurred for our direct benefit. Examples of these expenses include legal, accounting, interest on short-term debt and mortgages, tax preparation, directors' and officers' insurance, stock transfer services, stockholder-related fees, consulting and related fees. In addition, we are also responsible for all fees charged by third parties that are directly related to our business, which include real estate brokerage fees, mortgage placement fees, lease-up fees and transaction structuring fees (although we may be able to pass some or all of such fees on to our tenants and borrowers).

Advisory Agreement

On July 24, 2015, we entered into a second amended and restated advisory agreement, or the Second Amended Advisory Agreement, with the Adviser. Our entrance into the agreement was approved unanimously by our Board of Directors, including separate and unanimous approval by the independent directors on our Board of Directors.

The calculation of the annual base management fee was revised to equal 1.5% of our total stockholders' equity, (before giving effect to the base management and incentive fee), adjusted to exclude the effect of any unrealized gains or losses that do not affect realized net income (including impairment charges) and adjusted for any one-time events and certain non-cash items (only after approval of our Compensation Committee), or adjusted total stockholders' equity. The fee is calculated and accrued quarterly as 0.375% per quarter of such adjusted total stockholders' equity figure.

The calculation of the annual incentive fee was revised to reward the Adviser if our quarterly Core FFO (defined below), before giving effect to any incentive fee, or pre-incentive fee Core FFO, exceeds 2.0%, or 8.0% annualized, of adjusted total stockholders' equity (after giving effect to the base management fee but before giving effect to the incentive fee), or the new hurdle rate. The Adviser receives 15.0% of the amount of our pre-incentive fee Core FFO that exceeds the new hurdle rate. However, in no event shall the incentive fee for a particular quarter exceed the average quarterly incentive fee paid by us for the previous four quarters by greater than 15.0% (excluding quarters for which no incentive fee was paid). Core FFO is defined as GAAP net income (loss) available to common stockholders, excluding the incentive fee, depreciation and amortization, any unrealized gains, losses or other non-cash items recorded in net income (loss) available to common stockholders for the period, and one-time events pursuant to changes in GAAP.

A capital gains-based incentive fee was instituted that is calculated and payable in arrears as of the end of each fiscal year (or upon termination). In determining the capital gain fee, we will calculate aggregate realized capital gains and aggregate realized capital losses for the applicable time period. For this purpose, aggregate realized capital gains and losses, if any, equals the realized gain or loss calculated by the difference between the sales price of the property, less any costs to sell the property and the current gross value of the property (which is calculated as the original acquisition price plus any subsequent non-reimbursed capital improvements). At the end of the fiscal year, if this number is positive, then the capital gain fee payable for such time period shall equal 15.0% of such amount.

The Second Amended Advisory Agreement includes a termination fee where, in the event of a termination without cause (with 120 days' prior written notice and the vote of at least two-thirds of our independent directors), a termination fee would be payable to the Adviser equal to two times the sum of the average annual base management fee and incentive fee earned by the Adviser during the 24-month period prior to such termination. A termination fee is also payable if the Adviser terminates the agreement after the Company has defaulted and applicable cure periods have expired. The agreement may also be terminated for cause (with 30 days' prior written notice and the vote of at least two-thirds of our independent directors), with no termination fee payable. Cause is defined in the agreement to include if the Adviser breaches any material provisions of the Agreement, the bankruptcy or insolvency of the Adviser, dissolution of the Adviser and fraud or misappropriation of funds.

Table of Contents

On July 12, 2016, we further amended our advisory agreement with our Adviser by entering into a third amended and restated advisory agreement, to redefine the definition of adjusted stockholders' equity, to include total mezzanine equity, in the calculation of both the base management and incentive fee. All other provisions remained unchanged.The amended definition is effective as of July 1, 2016.

Administration Agreement

Pursuant to the Administration Agreement, we pay for our allocable portion of our Administrator’s overhead expenses incurred while performing its obligations to us, including, but not limited to, rent and the salaries and benefits expenses of our personnel, including our chief financial officer, treasurer, chief compliance officer, general counsel and secretary (who also serves as our Administrator’s president), and their respective staffs. Our allocable portion of the Administrator’s expenses is generally derived by multiplying our Administrator’s total expenses by the approximate percentage of time the Administrator’s employees perform services for us in relation to their time spent performing services for all companies serviced by our Administrator under contractual agreements.

Critical Accounting Policies

The preparation of our financial statements in accordance with Generally Accepted Accounting Principles in the U.S., or GAAP, requires management to make judgments that are subjective in nature in order to make certain estimates and assumptions. Application of these accounting policies involves the exercise of judgment regarding the use of assumptions as to future uncertainties, and as a result, actual results could materially differ from these estimates. A summary of all of our significant accounting policies is provided in Note 1 to our condensed consolidated financial statements in our 2015 Form 10-K. There were no material changes to our critical accounting policies during the six months ended June 30, 2016; however we issued mezzanine equity during the six months ended June 30, 2016, which is further described in Note 10.

Results of Operations

The weighted average yield on our total portfolio, which was 8.6% as of June 30, 2016 and 8.8% as of June 30, 2015, is calculated by taking the annualized straight-line rents, reflected as rental income on our condensed consolidated statements of operations, of each acquisition since inception as a percentage of the acquisition cost. The weighted average yield does not account for the interest expense incurred on the mortgages placed on our properties.

Table of Contents

A comparison of our operating results for the three and six months ended June 30, 2016 and 2015 is below (dollars in thousands, except per share amounts):

	For the three months ended June 30,			
	2016	2015	$ Change	% Change
Operating revenues				
Rental revenue	$20,890	$20,012	$878	4.4 %
Tenant recovery revenue	357	394	(37)	(9.4)%
Interest income from mortgage note receivable	—	282	(282)	(100.0)%
Total operating revenues	21,247	20,688	559	2.7 %
Operating expenses				
Depreciation and amortization	9,205	8,947	258	2.9 %
Property operating expenses	1,434	1,178	256	21.7 %
Acquisition related expenses	117	255	(138)	(54.1)%
Base management fee	856	866	(10)	(1.2)%
Incentive fee	655	1,760	(1,105)	(62.8)%
Administration fee	370	366	4	1.1 %
General and administrative	609	539	70	13.0 %
Impairment charge	187	—	187	NM
Total operating expenses before credit to incentive fee	13,433	13,911	(478)	(3.4)%
Credit to incentive fee	—	(1,316)	1,316	(100.0)%
Total operating expenses	13,433	12,595	838	6.7 %
Other (expense) income				
Interest expense	(6,579)	(6,999)	420	(6.0)%
Distributions attributable to Series C mandatorily redeemable preferred stock	(686)	(686)	—	— %
Other income	334	23	311	1,352.2 %
Total other expense	(6,931)	(7,662)	731	(9.5)%
Net income	883	431	452	104.9 %
Distributions attributable to Series A, B and D preferred stock	(1,263)	(1,023)	(240)	23.5 %
Distributions attributable to senior common stock	(251)	(261)	10	(3.8)%
Net loss attributable to common stockholders	$(631)	$(853)	$222	(26.0)%
Net loss attributable to common stockholders per weighted average share of common stock - basic & diluted	$(0.03)	$(0.04)	$0.01	(24.4)%
FFO available to common stockholders - basic	$8,761	$8,094	$667	8.2 %
FFO per weighted average share of common stock - basic	$0.39	$0.39	$—	— %
FFO per weighted average share of common stock - diluted	$0.38	$0.39 (1)	$(0.01)	(2.6)%

(1) Diluted FFO available to common stockholders was not previously adjusted for the income impact of the assumed conversion of senior common stock, in accordance with ASC 260 (“Earnings per Share”). This adjustment has increased Diluted FFO available to common stockholders for the three months ended June 30, 2015 by $0.02 per share.

NM - Not meaningful

Table of Contents

	For the six months ended June 30,			
	2016	2015	$ Change	% Change
Operating revenues				
Rental revenue	$41,547	$39,300	$2,247	5.7 %
Tenant recovery revenue	842	718	124	17.3 %
Interest income from mortgage note receivable	385	549	(164)	(29.9)%
Total operating revenues	42,774	40,567	2,207	5.4 %
Operating expenses				
Depreciation and amortization	18,338	17,154	1,184	6.9 %
Property operating expenses	3,045	2,139	906	42.4 %
Acquisition related expenses	126	451	(325)	(72.1)%
Base management fee	1,717	1,717	—	— %
Incentive fee	1,273	3,433	(2,160)	(62.9)%
Administration fee	775	728	47	6.5 %
General and administrative	1,184	1,229	(45)	(3.7)%
Impairment charge	230	—	230	NM
Total operating expenses before credit to incentive fee	26,688	26,851	(163)	(0.6)%
Credit to incentive fee	—	(2,500)	2,500	(100.0)%
Total operating expenses	26,688	24,351	2,337	9.6 %
Other (expense) income				
Interest expense	(13,310)	(13,770)	460	(3.3)%
Distributions attributable to Series C mandatorily redeemable preferred stock	(1,372)	(1,372)	—	— %
Other income	334	51	283	554.9 %
Total other expense	(14,348)	(15,091)	743	(4.9)%
Net income	1,738	1,125	613	54.5 %
Distributions attributable to Series A, B and D preferred stock	(2,290)	(2,047)	(243)	11.9 %
Distributions attributable to senior common stock	(504)	(485)	(19)	3.9 %
Net loss attributable to common stockholders	$(1,056)	$(1,407)	$351	(24.9)%
Net loss attributable to common stockholders per weighted average share of common stock - basic & diluted	(0.05)	(0.07)	$0.02	(28.6)%
FFO available to common stockholders - basic	$17,512	$15,747	$1,765	11.2 %
FFO per weighted average share of common stock - basic	$0.77	$0.77	$—	— %
FFO per weighted average share of common stock - diluted	$0.77	$0.76 [1]	$0.01	1.3 %

(1) Diluted FFO available to common stockholders was not previously adjusted for the income impact of the assumed conversion of senior common stock, in accordance with ASC 260 (“Earnings per Share”). This adjustment has increased Diluted FFO available to common stockholders for the six months ended June 30, 2015 by $0.02 per share.

NM - Not meaningful

Table of Contents

Same Store Analysis

For the purposes of the following discussion, same store properties are properties we owned as of January 1, 2015, which have not been subsequently vacated, or disposed of. Acquired and disposed of properties are properties which were either acquired, disposed of or classified as held for sale at any point subsequent to December 31, 2014. Properties with vacancy are properties that were fully or partially vacant at any point subsequent to January 1, 2015.

Operating Revenues

	For the three months ended June 30, (Dollars in Thousands)			
Rental Revenues	2016	2015	$ Change	% Change
Same Store Properties	$17,954	$17,794	$ 160	0.9 %
Acquired & Disposed Properties	2,236	1,380	856	62.0 %
Properties with Vacancy	700	838	(138)	(16.5)%
	$20,890	$20,012	$ 878	4.4 %

	For the six months ended June 30, (Dollars in Thousands)			
Rental Revenues	2016	2015	$ Change	% Change
Same Store Properties	$35,817	$35,580	$237	0.7 %
Acquired & Disposed Properties	4,336	1,935	2,401	124.1 %
Properties with Vacancy	1,394	1,785	(391)	(21.9)%
	$41,547	$39,300	$2,247	5.7 %

Rental revenue from same store properties increased slightly for the three and six months ended June 30, 2016, primarily because of additional rental income received from lease renewals at our Duncan, South Carolina and Raleigh, North Carolina properties, which were executed in 2015. Rental revenue increased for acquired and disposed properties for the three and six months ended June 30, 2016, as compared to the three and six months ended June 30, 2015, because we acquired three properties subsequent to June 30, 2015, and the inclusion of a full six months of rental revenue in 2016 for four properties acquired during the six months ended June 30, 2015. Rental revenue decreased for our properties with vacancy because the Newburyport, Massachusetts property went vacant in May 2015 coupled with reduced rent in our partially vacant Maple Heights, Ohio property; this was offset by increased rents at our Baytown, Texas, Burnsville, Minnesota and Raleigh, North Carolina properties from leasing vacant space.

	For the three months ended June 30, (Dollars in Thousands)			
Tenant Recovery Revenue	2016	2015	$ Change	% Change
Same Store Properties	$161	$194	$ (33)	(17.0)%
Acquired & Disposed Properties	192	189	3	1.6 %
Properties with Vacancy	4	11	(7)	(63.6)%
	$357	$394	$ (37)	(9.4)%

	For the six months ended June 30, (Dollars in Thousands)			
Tenant Recovery Revenue	2016	2015	$ Change	% Change
Same Store Properties	$400	$382	$ 18	4.7 %

Acquired & Disposed Properties	432	283