GLADSTONE COMMERCIAL CORP
Form 10-K
February 14, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2017
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)
Securities registered pursuant to Section 12(b) of the Act:

(Title of each Class)	(Name of each exchange on which registered)
Common Stock, $0.001 par value per share	Nasdaq Global Select Market
7.75% Series A Cumulative Redeemable Preferred Stock, par value $0.001 per share	Nasdaq Global Select Market
7.50% Series B Cumulative Redeemable Preferred Stock, par value $0.001 per share	Nasdaq Global Select Market
7.00% Series D Cumulative Redeemable Preferred Stock, par value $0.001 per share	Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO ý
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ¨ NO ý
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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth 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	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

The aggregate market value of the voting common stock held by non-affiliates of the Registrant on June 30, 2017, based on the closing price on that date of $21.79 on the Nasdaq Global Select Market, was $548,491,931. For the purposes of calculating this amount only, all directors and executive officers of the Registrant

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and entities controlled by our directors and executive officers have been treated as affiliates. There were 28,420,110 shares of the Registrant's common stock, $0.001 par value per share, outstanding as of February 14, 2018.
Documents Incorporated by Reference: Portions of the Registrant's Proxy Statement, to be filed no later than April 30, 2018, relating to the Registrant's 2018 Annual Meeting of Stockholders, are incorporated by reference into Part III of this Annual Report on Form 10-K.

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Forward-Looking Statements

Our disclosure and analysis in this Annual Report on Form 10-K ("Form 10-K"), and the documents that are incorporated by reference herein, contain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Ligation Reform Act of 1995 and include this statement for purposes of complying with these safe harbor provisions. Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends concerning matters that are not historical facts. These forward-looking statements include information about possible or assumed future events, including, among other things, discussion and analysis of our future financial condition, results of operations and funds from operations ("FFO"), our strategic plans and objectives, cost management, occupancy and leasing rates and trends, liquidity and ability to refinance our indebtedness as it matures, anticipated capital expenditures (and access to capital) required to complete projects, amounts of anticipated cash distributions to our stockholders in the future and other matters. Words such as “anticipates,” “expects,” “intends,” “plans,” “will,” “should,” “believes,” “seeks,” “est “may” and variations of these words and similar expressions are intended to identify forward-looking statements, though not all forward-looking statements contain these words. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control, are difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Statements regarding the following subjects, among others, are forward-looking by their nature:

- future re-leasing efforts;
- our business and financing strategy;
- our ability to continue to implement our business plan;
- pending transactions;
- our projected operating results and anticipated acquisitions;
- our ability to obtain future financing arrangements;
- estimates relating to our future distributions;
- our understanding of our competition and our ability to compete effectively;
- future market and industry trends;
- future interest and insurance rates;
- estimates of our future operating expenses, including payments to our Adviser (as defined herein) under the terms of our Advisory Agreement (as defined herein);
- the impact of technology on our operations and business, including the risk of cyber-attacks;
- projected capital expenditures; and
- future use of the proceeds of our Credit Facility (as defined herein), mortgage notes payable, future stock offerings and other future capital resources, if any.

Forward-looking statements involve inherent uncertainty and may ultimately prove to be incorrect or false. You are cautioned not to place undue reliance on forward-looking statements. Except as otherwise may be required by law, we undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or actual operating results. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including, but not limited to:

- general volatility of the capital markets and the market price of our common and preferred stock;
- failure to maintain our qualification as a real estate investment trust ("REIT") and in the risk of changing laws that affect REITs;
- risks associated with negotiation and consummation of pending and future transactions;

- changes in our business strategy;
- the adequacy of our cash reserves and working capital;
- our failure to successfully integrate and operate acquired properties and operations;
- defaults upon or non-renewal of leases by tenants;
- decreased rental rates or increased vacancy rates;
- the degree and nature of our competition, including other real estate investment companies;
- availability, terms and deployment of capital, including the ability to maintain and borrow under our Credit Facility, arrange for long-term mortgages on our properties, secure additional long-term lines of credit and raise equity capital;
- our Adviser's ability to identify, hire and retain highly-qualified personnel;
- changes in our industry or the general economy;
- changes in real estate and zoning laws and increases in real property tax rates;

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- changes in governmental regulations, tax rates and similar matters;
- environmental uncertainties and risks related to natural disasters; and
- the loss of any of our key officers, such as Mr. David Gladstone, our chairman and chief executive officer, Mr. Terry Lee Brubaker, our vice chairman and chief operating officer, or Mr. Robert Cutlip, our president.

This list of risks and uncertainties, however, is only a summary of some of the most important factors to us and is not intended to be exhaustive. You should carefully review the risks set forth herein under the caption “Item 1A. Risk Factors.” New factors may also emerge from time to time that could have a material adverse effect on our business.

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PART I

Item 1. Business.

Overview

Gladstone Commercial Corporation (which we refer to as “we,” “us,” or the “Company”) is a 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 office mortgage loans; however we do not have any mortgage loans currently outstanding. 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 seven to 15 years with built-in rental rate increases. Under a net lease, the tenant is required to pay most or all operating, maintenance, repair and insurance costs and real estate taxes with respect to the leased property.

As of February 14, 2018:

- we owned 99 properties totaling 11.5 million square feet (all references to the number of properties and square footage are unaudited herein and throughout Notes) of rentable space in 24 states;
- our occupancy rate was 97.9%;
- the weighted average remaining term of our mortgage debt was 6.5 years and the weighted average interest rate was 4.6%; and
- the average remaining lease term of the portfolio was 7.5 years.

We conduct substantially all of our activities, including the ownership of all of our properties, through Gladstone Commercial Limited Partnership, a Delaware limited partnership, which we refer to as our Operating Partnership. We control our Operating Partnership through our ownership of GCLP Business Trust II, a Massachusetts business trust, which is the general partner of our Operating Partnership, and of GCLP Business Trust I, a Massachusetts business trust, which currently holds all of the limited partnership units of our Operating Partnership. Our Operating Partnership may issue limited partnership units from time to time in exchange for industrial and office real property; however, no units have been issued since inception. Limited partners who hold limited partnership units in our Operating Partnership for one year will generally be entitled to cause us to redeem these units for cash or, at our election, shares of our common stock on a one-for-one basis.

Our Operating Partnership is the sole member of Gladstone Commercial Lending, LLC, which we refer to as Gladstone Commercial Lending. Gladstone Commercial Lending is a Delaware limited liability company that was formed to hold any real estate mortgage loans.

Our business is managed by our external adviser, Gladstone Management Corporation (the "Adviser"). Gladstone Administration, LLC (the "Administrator"), provides administrative services to us. Both our Adviser and our Administrator are affiliates of ours and each other.

Our Investment Objectives and Our Strategy

Our principal investment objectives are to generate income from rental properties and, to a much lesser extent, mortgage loans, which we use to fund our continuing operations and to pay monthly cash distributions to our stockholders. Our strategy is to invest in and own a diversified portfolio of leased properties (primarily office and industrial) that we believe will produce stable cash flow and increase in value. We may sell some of our real estate assets when our Adviser determines that doing so would be advantageous to us and our stockholders. We also expect to occasionally make mortgage loans secured by income-producing office or industrial real estate, which loans may have some form of equity participation. We do not have any mortgage loans currently outstanding.

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In addition to cash on hand and cash from operations, we use funds from various other sources to finance our acquisitions and operations, including equity, our Credit Facility (as defined herein), mortgage financing and other sources that may become available from time to time. We believe that moderate leverage is prudent and we aspire to become an investment grade borrower over time. We intend to primarily use non-recourse mortgage financing that will allow us to limit our loss exposure on any property to the amount of equity invested in such property.

In addition to leverage, we were active in the equity markets during 2017 by issuing shares of common stock and preferred stock under our at-the-market programs ("ATM Programs"), pursuant to our open market sale agreements with Cantor Fitzgerald & Co. ("Cantor Fitzgerald"). We also issued common stock through one overnight offering.

Investment Policies

Types of Investments

Overview

We intend to earn substantially all of our revenues from the ownership of income-producing real property or, to a much lesser extent, mortgage loans secured by real property. We expect that a majority of our investments will continue to be structured as net leases that require the tenant to pay most or all of the operating costs, costs of maintenance and repair, insurance and real estate taxes on the property. However, if a net lease would have an adverse impact on a potential tenant, or we assume a lease with a different existing structure in place, we may structure our investment as either a gross or modified gross lease, or as a mortgage loan. Investments are not restricted to geographical areas, but we expect that most of our investments in real estate will continue to be made within the continental United States. Some of our investments may also be made through joint ventures that would permit us to own interests in large properties without restricting the diversity of our portfolio.

We anticipate that we will make substantially all of our investments through our Operating Partnership. Our Operating Partnership may acquire interests in real property or mortgage loans in exchange for the issuance of limited partnership units, for cash or through a combination of both. Units issued by our Operating Partnership generally will be redeemable for cash or, at our election, shares of our common stock on a one-for-one basis. However, we may in the future also conduct some of our business and hold some of our interests in real properties or mortgage loans through one or more wholly-owned subsidiaries that are not owned, directly or indirectly, through our Operating Partnership. We have not issued any limited partnership units to date.

Property Acquisitions and Net Leasing

To date, we have purchased a majority of our properties from owners that have leased their properties to non-affiliated tenants, and while we have engaged in some transactions with tenants who have consummated sale-leaseback transactions, these transactions do not comprise the dominant portion of our portfolio. We expect that some of our sale-leaseback transactions will be in conjunction with acquisitions, recapitalizations or other corporate transactions affecting our tenants. In these transactions, we may act as one of several sources of financing by purchasing one or more properties from the tenant and by leasing it on a net basis to the tenant or its successor in interest.

Our portfolio consists primarily of single-tenant office and industrial real property; while we will continue to acquire select multi-tenant office and industrial properties, our primary focus is single-tenant industrial and office properties. Generally, we lease properties to tenants that our Adviser deems creditworthy under leases that will be full recourse obligations of our tenants or their affiliates. We seek to obtain lease terms of approximately seven to 15 years with built-in rental increases.

We have formed relationships with nationally recognized strategic partners to assist us with the management of our properties in each of our markets. These relationships provide local expertise to ensure that our properties are properly maintained and that our tenants have local points of contact to address property issues. This strategy improves our operating efficiencies, increases local market intelligence for the Adviser, and generally does not increase our costs as the local property managers are reimbursed by the tenants in accordance with the lease agreements.

Investments in Mortgage Loans

Although we expect to make investments in mortgage loans sparingly, we may elect to structure our investment in a particular property as a mortgage loan secured by the property. We anticipate that most of our lending transactions would be loans secured by industrial or office property or issued in connection with a build-to-suit transaction. Our Adviser will attempt to structure mortgage loans in a manner that would provide us with current income substantially similar to that which we could expect to receive had the investment been structured as a net lease transaction.

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To the extent that we invest in mortgage loans, we will generally originate those loans. However, we may also purchase mortgage loans from banks, collateralized mortgage backed securities ("CMBS") pools or other lenders provided that such transactions are otherwise consistent with our investment objectives. Our Adviser will service the mortgage loans in our portfolio by monitoring the collection of monthly principal and interest payments on our behalf. We do not have any mortgage loans currently outstanding.

Underwriting Criteria, Due Diligence Process and Negotiating Lease Provisions

We consider underwriting of the real estate and the tenant for the property (or the borrower in the case of a mortgage loan) to be the two most important aspects of evaluating a prospective investment. In analyzing potential acquisitions of properties and leases, our Adviser reviews all aspects of the potential transaction, including tenant and real estate fundamentals, to determine whether potential acquisitions and leases can be structured to satisfy our acquisition criteria. The criteria listed below provide general guideposts that our Adviser may consider when underwriting leases and mortgage loans:

- Credit Evaluation. Our Adviser evaluates each potential tenant or borrower for its creditworthiness, considering factors such as its rating by a national credit rating agency, if any, management experience, industry position and fundamentals, operating history and capital structure. As of December 31, 2017, 42% of our rental revenues were earned from tenants that were rated by a national credit rating agency. A prospective tenant or borrower that is deemed creditworthy does not necessarily mean that we will consider its property to be “investment grade.” Our Adviser seeks tenants and borrowers that range from small businesses, many of which do not have publicly rated debt, to large public companies. Our Adviser’s investment professionals have substantial experience in locating and underwriting these types of companies. By leasing properties to these tenants, we believe that we will generally be able to charge rent that is higher than the rent charged to tenants with unleveraged balance sheets and recognized credit, thereby enhancing current return from these properties as compared with properties leased to companies whose credit potential has already been recognized by the market. Furthermore, if a tenant’s credit improves, the value of our lease or investment will likely increase (if all other factors affecting value remain unchanged). In evaluating a possible investment, we believe that the creditworthiness of a prospective tenant is normally a more significant factor than the unleased value of the property itself. While our Adviser selects tenants it believes to be creditworthy, tenants are not required to meet any minimum rating established by an independent credit rating agency. Our Adviser’s standards for determining whether a particular tenant is creditworthy vary in accordance with a variety of factors relating to specific prospective tenants. The creditworthiness of a tenant or borrower is determined on a tenant-by-tenant and case-by-case basis. Therefore, general standards for creditworthiness cannot be applied.

- Leases with Increasing Rent. Our Adviser seeks to include a provision in each lease that provides for annual rent escalations over the term of the lease. A majority of our leases contain fixed rental escalations; however certain of our leases are tied to increases in indices, such as the consumer price index.

- Diversification. Our Adviser attempts to diversify our portfolio to avoid dependence on any one particular tenant, facility type, geographic location or tenant industry. By diversifying our portfolio, our Adviser intends to reduce the adverse effect of a single under-performing investment or a downturn in any particular industry or geographic region. Please see Item 2 of this Form 10-K for a summary of our portfolio by industry and geographic location.

- Property Valuation. The business prospects and the financial strength of the tenant are important aspects of the evaluation of any sale and leaseback of property, or acquisition of property subject to a net lease, particularly a property that is specifically suited to the needs of the tenant. We generally require quarterly unaudited and annual audited financial statements of the tenant in order to continuously monitor the financial performance of the tenant. Our Adviser evaluates the financial capability of the tenant and its ability to perform per the terms of the lease, including obtaining certificates of insurance and verifying payment of real estate taxes on an annual basis. Our Adviser may also examine the available operating results of prospective investment properties to determine whether or not projected rental levels are likely to be met. As further described below, our Adviser also evaluates the physical characteristics of a prospective property investment and comparable properties as well as the geographic location of the property in the particular market to ensure that the characteristics are favorable for re-leasing the property at approximately the same or higher rental rate should that necessity arise. Our Adviser then computes the value of the property based on historical and projected operating results. In addition, each property that we propose to purchase is appraised by an independent appraiser. These appraisals may take into consideration, among other things, the terms and conditions of the particular lease transaction and the conditions of the credit markets at the time the purchase is negotiated. We generally limit the purchase price of each acquisition to less than 5% of our consolidated total assets.

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- Properties Important to Tenant Operations. Our Adviser generally seeks to acquire investment properties that are essential or important to the ongoing operations of the prospective tenant. We believe that these investment properties provide better protection in the event a tenant files bankruptcy, as leases on properties essential or important to the operations of a bankrupt tenant are typically less likely to be rejected in bankruptcy or otherwise terminated.

- Lease Provisions that Enhance and Protect Value. When appropriate, our Adviser attempts to include provisions in our leases that require our consent to specified tenant activity or require the tenant to satisfy specific operating tests. These provisions may include operational or financial covenants of the tenant, as well as indemnification of us by the tenant against environmental and other contingent liabilities. We believe that these provisions serve to protect our investments from changes in the operating and financial characteristics of a tenant that may impact its ability to satisfy its obligations to us or that could reduce the value of our properties. Our Adviser generally also seeks covenants requiring tenants to receive our consent prior to any change in control of the tenant.

- Credit Enhancement. Our Adviser may also seek to enhance the likelihood of a tenant's lease obligations being satisfied through a cross-default with other tenant obligations, a letter of credit or a guaranty of lease obligations from each tenant's corporate parent. We believe that this type of credit enhancement, if obtained, provides us with additional financial security.

Underwriting of the Real Estate and Due Diligence Process

In addition to underwriting the tenant or borrower, our Adviser also underwrites the real estate to be acquired or secured by one of our mortgages. On our behalf, our Adviser performs a due diligence review with respect to each property, such as evaluating the physical condition of a property, zoning and site requirements to ensure the property is in compliance with all zoning regulations as well as an environmental site assessment, in an attempt to determine potential environmental liabilities associated with a property prior to its acquisition, although there can be no assurance that hazardous substances or wastes (as defined by present or future federal or state laws or regulations) will not be discovered on the property after we acquire it. We could incur significant costs related to government regulation and private litigation over environmental matters. See "Risk Factors – We could be exposed to liability and remedial costs related to environmental matters."

Our Adviser also reviews the structural soundness of the improvements on the property and may engage a structural engineer to review multiple aspects of the structures to determine the longevity of each building on the property. This review normally also includes the components of each building, such as the roof, the structure and configuration, the electrical wiring, the heating and air-conditioning system, the plumbing, parking lot and various other aspects such as compliance with state and federal building codes.

Our Adviser also physically inspects the real estate and surrounding real estate as part of determining its value. This aspect of our Adviser's due diligence is aimed at arriving at a valuation of the real estate under the assumption that it would not be rented to the existing tenant. As part of this process, our Adviser may consider one or more of the following items:

- The comparable value of similar real estate in the same general area of the prospective property. In this regard, comparable property is difficult to define because each piece of real estate has its own distinct characteristics. But to the extent possible, comparable property in the area that has sold or is for sale will be used to determine if the price to be paid for the property is reasonable. The question of comparable properties' sale prices is particularly relevant if a property might be sold by us at a later date.

- An assessment of the relative appropriate nature and flexibility of the building configuration and its ability to be re-leased to other users in a single or multiple tenant arrangement.

- The comparable real estate rental rates for similar properties in the same area of the prospective property.

- Alternative property uses that may offer higher value.

- The replacement cost of the property at current construction prices if it were to be sold.

- The assessed value as determined by the local real estate taxing authority.

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

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Use of Leverage

In addition to cash on hand and cash from operations, we use funds from various other sources to finance our acquisitions and operations, including common and preferred equity, our Credit Facility, mortgage financing and other sources that may become available from time to time. We believe that moderate leverage is prudent and we aspire to achieve an investment grade rating over time.

Currently, the majority of our mortgage borrowings are structured as non-recourse to us, with limited exceptions that would trigger recourse to us only upon the occurrence of certain fraud, misconduct, environmental or bankruptcy events. The use of non-recourse financing allows us to limit our exposure to the amount of equity invested in the properties pledged as collateral for our borrowings. Non-recourse financing generally restricts a lender's claim on the assets of the borrower, and as a result, the lender generally may look only to the property securing the debt for its satisfaction. We believe that this financing strategy, to the extent available, protects our other assets. However, we can provide no assurance that non-recourse financing will be available on terms acceptable to us, or at all, and consequently, there may be circumstances where lenders have recourse to our other assets. To a much lesser extent, we use recourse financing. Of the $447.4 million in mortgage notes payable, net, outstanding as of December 31, 2017, only $11.7 million is recourse to the Company, or 2.6% of the total amount outstanding.

On August 7, 2013, we procured a senior unsecured revolving credit facility ("Revolver"), with KeyBank National Association (serving as a revolving lender, a letter of credit issuer and an administrative agent) and other syndicated lenders. Our Revolver was initially for $60.0 million, but was increased to $85.0 million through subsequent amendments, with the latest amendment occurring on October 27, 2017. On October 5, 2015, we added a $25.0 million 5-year term loan facility ("Term Loan"). On October 27, 2017, we expanded our Term Loan to $75.0 million and extended the maturity date to October 27, 2022, and also extended the maturity date of our Revolver through October 27, 2021. The Revolver and the Term Loan are referred to collectively herein as the Credit Facility.

Conflict of Interest Policy

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

Under our current conflict of interest policy, without the approval of a majority of our independent directors, we will not:

- acquire from or sell any assets or other property to any of our officers, directors or our Adviser's employees, or any entity in which any of our officers, directors or Adviser's employees has an interest of more than 5%;
- borrow from any of our directors, officers or our Adviser's employees, or any entity, in which any of our officers, directors or our Adviser's employees has an interest of more than 5%; or
- engage in any other transaction with any of our directors, officers or our Adviser's employees, or any entity in which any of our directors, officers or our Adviser's employees has an interest of more than 5% (except that our Adviser may lease office space in a building that we own, provided that the rental rate under the lease is determined by our independent directors to be at a fair market rate).

Our policy also prohibits us from purchasing any real property owned by or co-investing with our Adviser, any of its affiliates or any business in which our Adviser or any of its subsidiaries have invested, except that we may lease property to existing and prospective portfolio companies of current or future affiliates, such as our affiliated publicly-traded funds Gladstone Capital Corporation ("Gladstone Capital"), Gladstone Land Corporation ("Gladstone Land") or Gladstone Investment Corporation ("Gladstone Investment"), and other entities advised by our Adviser, so long as that entity does not control the portfolio company and the transaction is approved by both companies’ board of directors. If we decide to change this policy on co-investments with our Adviser or its affiliates, we will seek our stockholders’ approval.

Future Revisions in Policies and Strategies

Our independent directors periodically review our investment policies to evaluate whether they are in the best interests of us and our stockholders. Our investment procedures, objectives and policies may vary as new investment techniques are developed or as regulatory requirements change, and except as otherwise provided in our charter or bylaws, may be altered by a majority of our directors (including a majority of our independent directors) without the approval of our stockholders, to the extent that our Board of Directors determines that such modification is in the best interest of our stockholders. Among other factors, developments in the market which affect the policies and strategies described in this report or which change our assessment of the market may cause our Board of Directors to revise our investment policies and strategies.

Code of Ethics

We have adopted a code of ethics and business conduct applicable to all personnel of our Adviser that complies with the guidelines set forth in Item 406 of Regulation S-K of the Securities Act of 1933, as amended. This code establishes procedures for personal investments, restricts certain transactions by such personnel and requires the reporting of certain transactions and holdings by such personnel. A copy of this code is available for review, free of charge, at our website at www.GladstoneCommercial.com. We intend to provide any required disclosure of any amendments to or waivers of the provisions of this code by posting information regarding any such amendment or waiver to our website within four days of its effectiveness.

Our Adviser and Administrator

Our business is managed by our Adviser. The officers, directors and employees of our Adviser have significant experience in making investments in and lending to businesses of all sizes, and investing in real estate and making mortgage loans. We have entered into an investment advisory agreement with our Adviser, as amended (the "Advisory Agreement"), under which our Adviser is responsible for managing our assets and liabilities, for operating our business on a day-to-day basis and for identifying, evaluating, negotiating and consummating investment transactions consistent with our investment policies as determined by our Board of Directors from time to time. The Administrator employs our chief financial officer, treasurer, chief compliance officer, and general counsel and secretary (who also serves as our Administrator’s president, general counsel, and secretary) and their respective staffs and provides administrative services for us under the Administration Agreement.

David Gladstone, our chairman and chief executive officer, is also the chairman, chief executive officer and the controlling stockholder of our Adviser and our Administrator. Terry Lee Brubaker, our vice chairman and chief operating officer, also serves in the same capacities for our Adviser and our Administrator. Robert Cutlip, our president, is also an executive managing director of our Adviser.

Our Adviser has an investment committee that approves each of our investments. This investment committee is currently comprised of Messrs. Gladstone, Cutlip and Brubaker. We believe that the review process of our investment committee gives us a unique competitive advantage over other REITs because of the substantial experience that its members possess and their unique perspective in evaluating the blend of corporate credit, real estate and lease terms that collectively provide an acceptable risk for our investments.

Our Adviser’s board of directors has empowered our investment committee to authorize and approve our investments, subject to the terms of the Advisory Agreement. Before we acquire any property, the transaction is reviewed by our investment committee to ensure that, in its view, the proposed transaction satisfies our investment criteria and is within our investment policies. Approval by our investment committee is generally the final step in the property acquisition approval process, although the separate approval of our Board of Directors is required in certain circumstances described below. For further detail on this process, please see “Investment Policies—Underwriting Criteria, Due Diligence Process and Negotiating Lease Provisions.”

Our Adviser and Administrator are headquartered in McLean, Virginia, a suburb of Washington, D.C., and our Adviser also has offices in other states. Refer to Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Advisory and Administration Agreements" for a detailed discussion on the Adviser and Administrator's fee structure.

Adviser Duties and Authority under the Advisory Agreement

Under the terms of the Advisory Agreement, our Adviser is required to use its best efforts to present to us investment opportunities consistent with our investment policies and objectives as adopted by our Board of Directors. In performing its duties, our Adviser, either directly or indirectly by engaging an affiliate:

- finds, evaluates and enters into contracts to purchase real estate and make mortgage loans on our behalf in compliance with our investment procedures, objectives and policies, subject to approval of our Board of Directors, where required;

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- provides advice to us and acts on our behalf with respect to the negotiation, acquisition, financing, refinancing, holding, leasing and disposition of real estate investments;

- takes the actions and obtains the services necessary to effect the negotiation, acquisition, financing, refinancing, holding, leasing and disposition of real estate investments; and

- provides day-to-day management of our business activities and other administrative services for us as requested by our Board of Directors.

Our Board of Directors has authorized our Adviser to make investments in any property on our behalf without the prior approval of our Board of Directors if the following conditions are satisfied:

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

- our Adviser has concluded that the property, in conjunction with our other investments and proposed investments, is reasonably expected to fulfill our investment objectives and policies as established by our Board of Directors then in effect.

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

- loans not secured or otherwise supported by real property;

- any acquisition or mortgage loan which at the time of investment would have a cost exceeding 20% of our total assets;

- transactions that involve conflicts of interest with our Adviser or other affiliates (other than reimbursement of expenses in accordance with the Advisory Agreement); and

- the lease of assets to our Adviser, its affiliates or any of our officers or directors.

Our Adviser and Administrator also engage in other business ventures and, as a result, their resources are not dedicated exclusively to our business. For example, our Adviser and Administrator also serve as the external adviser or administrator, respectively, to Gladstone Capital and Gladstone Investment, both publicly traded business development companies affiliated with us, and Gladstone Land Corporation, a publicly traded agricultural real estate investment trust that is also our affiliate. However, under the Advisory Agreement, our Adviser is required to devote sufficient resources to the administration of our affairs to discharge its obligations under the agreement. The Advisory Agreement is not assignable or transferable by either us or our Adviser without the consent of the other party, except that our Adviser may assign the Advisory Agreement to an affiliate for whom our Adviser agrees to guarantee its obligations to us.

Gladstone Securities

Gladstone Securities, LLC ("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 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 convertible senior common stock ("Senior Common Stock"), we entered into a Dealer Manager Agreement, dated March 25, 2011 (the "Dealer Manager Agreement"), with Gladstone Securities (the "Dealer Manager"), pursuant to which the Dealer Manager 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. Pursuant to the terms of the Dealer Manager Agreement, the Dealer Manager 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 the Dealer Manager against various liabilities, including certain liabilities arising under the federal securities laws.

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Mortgage Financing Arrangement Agreement

We also 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, will be 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. The agreement is scheduled to terminate on August 31, 2018, unless renewed and approved by our Board of Directors or earlier terminated.

Employees

We do not currently have any employees and do not expect to have any employees in the foreseeable future. Currently, services necessary for our business are provided by individuals who are employees of our Adviser and our Administrator pursuant to the terms of the Advisory Agreement and the Administration Agreement, respectively. Each of our executive officers is an employee or officer, or both, of our Adviser or our Administrator. We expect that a total of 15 to 20 full time employees of our Adviser and our Administrator will spend substantially all or all of their time on our matters during calendar year 2018. Our President and CFO, accounting team, and the employees of our Adviser that manage our assets and our investments spend all of their time on our matters. To the extent that we acquire more investments, we anticipate that the number of employees of our Adviser and our Administrator who devote time to our matters will increase.

As of December 31, 2017, our Adviser and Administrator collectively had 65 full-time employees. A breakdown of these employees is summarized by functional area in the table below:

Number of Individuals	Functional Area
12	Executive Management
36	Investment Management, Asset Management, Portfolio Management and Due Diligence
17	Administration, Accounting, Compliance, Human Resources, Legal and Treasury

Competition

We compete with a number of other real estate investment companies and traditional mortgage lenders, many of whom have greater marketing and financial resources than we do. Principal factors of competition in our primary business of investing in and owning leased industrial and office real property are the quality of properties, leasing terms, attractiveness and convenience of location. Additionally, our ability to compete depends upon, among other factors, trends of the national and local economies, investment alternatives, financial condition and operating results of current and prospective tenants and borrowers, availability and cost of capital, taxes and governmental regulations.

Available Information

Copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and amendments, if any, to those reports filed or furnished with the Securities and Exchange Commission (the "SEC"), pursuant to Section 13(a) or 15(d) of the Securities Exchange Act are available free of charge through our website at www.GladstoneCommercial.com as soon as practicable after such reports have been filed or furnished to the SEC. A request for any of these reports may also be submitted to us by sending a written request addressed to Investor Relations, Gladstone Commercial Corporation, 1521 Westbranch Drive, Suite 100, McLean, VA 22102, or by calling our toll-free investor relations line at 1-866-366-5745. The public may read and copy materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

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Item 1A. Risk Factors.

An investment in our securities involves a number of significant risks and other factors relating to our structure and investment objectives. As a result, we cannot assure you that we will achieve our investment objectives. You should consider carefully the following information before making an investment in our securities.

Risks related to our business and properties

Certain of our tenants and borrowers may be unable to pay rent or make mortgage payments, which could adversely affect our cash available to make distributions to our stockholders.

Some of our tenants and borrowers may have recently been either restructured using leverage, or acquired in a leveraged transaction. Tenants and borrowers that are subject to significant debt obligations may be unable to make their rent or mortgage payments if there are adverse changes to their businesses or because of the impact of the recent recession or recurrence of a similar event. Tenants that have experienced leveraged restructurings or acquisitions will generally have substantially greater debt and substantially lower net worth than they had prior to the leveraged transaction. In addition, the payment of rent and debt service may reduce the working capital available to leveraged entities and prevent them from devoting the resources necessary to remain competitive in their industries.

In situations where management of the tenant or borrower will change after a transaction, it may be difficult for our Adviser to determine with reasonable certainty the likelihood of the tenant's or borrower's business success and of its ability to pay rent or make mortgage payments throughout the lease or loan term. These companies generally are more vulnerable to adverse economic and business conditions, and increases in interest rates.

We are subject to the credit risk of our tenants, which in the event of bankruptcy, could adversely affect our results of operations.

We are subject to the credit risk of our tenants. Any bankruptcy of a tenant or borrower could cause:

- the loss of lease or mortgage payments to us;

- an increase in the costs we incur to carry the property occupied by such tenant;

- a reduction in the value of our securities; or

- a decrease in distributions to our stockholders.

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

In addition, we may enter into sale-leaseback transactions, whereby we would purchase a property and then lease the same property back to the person from whom we purchased it. In the event of the bankruptcy of a tenant, a transaction structured as a sale-leaseback may be re-characterized as either a financing or a joint venture, either of which outcomes could adversely affect our business. If the sale-leaseback were re-characterized as a financing, we might not be considered the owner of the property, and as a result would have the status of a creditor in relation to the tenant. In that event, we would no longer have the right to sell or encumber our ownership interest in the property. Instead, we would have a claim against the tenant for the amounts owed under the lease, with the claim arguably secured by the property. The tenant/debtor might have the ability to propose a plan restructuring the term, interest rate and amortization schedule of its outstanding balance. If confirmed by the bankruptcy court, we could be bound by the new terms, and prevented from foreclosing our lien on the property. If the sale-leaseback were re-characterized as a joint venture, we could be treated as a co-venturer with our lessee with regard to the property. As a result, we could be held liable, under some circumstances, for debts incurred by the lessee relating to the property. Either of these outcomes could adversely affect our cash flow and our ability to pay distributions to stockholders.

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We may be unable to renew leases, lease vacant space or re-lease space as leases expire, which could adversely affect our business and our ability to make distributions to our stockholders.

If we cannot renew leases, we may be unable to re-lease our properties to other tenants at rates equal to or above the current market rate. Even if we can renew leases, tenants may be able to negotiate lower rates as a result of market conditions. Market conditions may also hinder our ability to lease vacant space in newly developed or redeveloped properties. In addition, we may enter into or acquire leases for properties that are suited to the needs of a particular tenant. Such properties may require renovations, tenant improvements or other concessions in order to lease them to other tenants if the initial leases terminate. We may be required to expend substantial funds for tenant improvements and tenant refurbishments to re-lease the vacated space and cannot assure you that we will have sufficient sources of funding available to use in the future for such purposes and therefore may have difficulty in securing a replacement tenant. Any of these factors could adversely impact our financial condition, results of operations, cash flow or our ability to pay distributions to our stockholders.

Net leases may not result in fair market lease rates over time, thereby failing to maximize income and distributions to our stockholders.

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

Multi-tenant properties expose us to additional risks.

Our multi-tenant properties could expose us to the risk that a sufficient number of suitable tenants may not be found to enable the property to operate profitably. This loss of income could cause a material adverse impact to our results of operations and business. Multi-tenant properties are also subject to tenant turnover and fluctuation in occupancy rates, which could affect our operating results. Furthermore, multi-tenant properties expose us to the risk of increased operating expenses, which may occur when the actual cost of taxes, insurance and maintenance at the property exceeds the operating expenses paid by tenants and/or the amounts budgeted.

We face certain risks associated with our build-to-suit activities.

We may (1) provide a developer with either a combination of financing for construction of a build-to-suit property or a commitment to acquire a property upon completion of construction of a build-to-suit property and commencement of rent from the tenant or (2) acquire a property subject to a lease and engage a developer to complete construction of a build-to-suit property as required by the lease. We face uncertainties associated with a developer’s timely performance and timely completion of a project, including the performance or timely completion of contractors and subcontractors. If a developer, contractor or subcontractor fails to perform, we may resort to legal action to compel performance, remove the developer or rescind the purchase or construction contract. We may also incur additional risks as we make periodic payments or other advances to developers before completion of construction. These and other factors can result in increased costs of a project or loss of our investment, and may be affected by conditions beyond both our and the developer’s control.

Illiquidity of real estate investments may make it difficult for us to sell properties in response to market conditions and could harm our financial condition and ability to make distributions to our stockholders.

To the extent the properties are not subject to triple-net leases, some significant expenditures, such as real estate taxes and maintenance costs, are generally not reduced when circumstances cause a reduction in income from the investment. Should these events occur, our income and funds available for distribution could be adversely affected. In addition, as a REIT, we may be subject to a 100% tax on net income derived from the sale of property considered to be held primarily for sale to customers in the ordinary course of our business. We may seek to avoid this tax by complying with certain safe harbor rules that generally limit the number of properties we may sell in a given year, the aggregate expenditures made on such properties prior to their disposition, and how long we retain such properties before disposing of them. However, we can provide no assurance that we will always be able to comply with these safe harbors. If compliance is possible, the safe harbor rules may restrict our ability to sell assets in the future and achieve liquidity that may be necessary to fund distributions.

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

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We focus our investments on office and industrial properties, a number of which include manufacturing facilities, special use storage or warehouse facilities and special use single or multi-tenant properties. These types of properties are relatively illiquid compared to other types of real estate and financial assets. This illiquidity will limit our ability to quickly change our portfolio in response to changes in economic or other conditions. With these properties, if the current lease is terminated or not renewed or, in the case of a mortgage loan, if we take such property in foreclosure, we may be required to renovate the property or to make rent concessions in order to lease the property to another tenant or sell the property. In addition, in the event we are forced to sell the property, we may have difficulty selling it to a party other than the tenant or borrower due to the special purpose for which the property may have been designed.

These and other limitations may affect our ability to sell or re-lease properties without adversely affecting returns to our stockholders.

Many of our tenants are lower middle market businesses, which exposes us to additional risks unique to these entities.

Leasing real property or making mortgage loans to lower middle market businesses exposes us to a number of unique risks related to these entities, including the following:

- Lower middle market businesses may have limited financial resources and may not be able to make their lease or mortgage payments on a timely basis, or at all. A lower middle market tenant or borrower may be more likely to have difficulty making its lease or mortgage payments when it experiences adverse events, such as the failure to meet its business plan, a downturn in its industry or negative economic conditions because its financial resources may be more limited.

- Lower middle market businesses typically have narrower product lines and smaller market shares than large businesses. Because our target tenants and borrowers are typically smaller businesses that may have narrower product lines and smaller market share, they may be more vulnerable to competitors' actions and market conditions, as well as general economic downturns.

- There is generally little or no publicly available information about our target tenants and borrowers. Many of our tenants and borrowers are privately owned businesses, about which there is generally little or no publicly available operating and financial information. As a result, we will rely on our Adviser to perform due diligence investigations of these tenants and borrowers, their operations and their prospects. We may not learn all of the material information we need to know regarding these businesses through our investigations.

- Lower middle market businesses generally have less predictable operating results. We expect that many of our tenants and borrowers may experience significant fluctuations in their operating results, may from time to time be parties to litigation, may be engaged in rapidly changing businesses with products subject to a substantial risk of obsolescence, may require substantial additional capital to support their operations, to finance expansion or to maintain their competitive positions, may otherwise have a weak financial position or may be adversely affected by changes in the business cycle.

- Lower middle market businesses are more likely to be dependent on one or two persons. Typically, the success of a lower middle market business also depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of one or more of these persons could have a material adverse impact on our tenant or borrower and, in turn, on us.

Our real estate investments have a limited number of tenants and are concentrated in a limited number of industries, which subjects us to an increased risk of significant loss if any one of these tenants is unable to pay or if particular industries experience downturns.

As of December 31, 2017, we owned 99 properties and had 107 leases on these properties, and our five largest tenants accounted for approximately 17.1% of our total rental income. A consequence of a limited number of tenants is that the aggregate returns we realize may be materially adversely affected by the unfavorable performance of a small number of tenants. We generally do not have fixed guidelines for industry concentration, but we are restricted from exceeding an industry concentration greater than 20% without approval of our investment committee. As of December 31, 2017, 16.7% of our total rental income was earned from tenants in the Telecommunications industry, 14.0% was earned from tenants in the Healthcare industry, and 12.0% was earned from tenants in the Automobile industry. As a result, a downturn in an industry in which we have invested a significant portion of our total assets could have a material adverse effect on us.

The inability of a tenant in a single tenant property to pay rent will reduce our revenues and increase our carrying costs of the building.

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Since most of our properties are occupied by a single tenant, the success of each investment will be materially dependent on the financial stability of these tenants. If a tenant defaults, our rental revenues would be reduced and our expenses associated with carrying the property would increase, as we would be responsible for payments such as taxes and insurance. Lease payment defaults by these tenants could adversely affect our cash flows and cause us to reduce the amount of distributions to stockholders. In the event of a default by a tenant, we may experience delays in enforcing our rights as landlord and may incur substantial costs in protecting our investment and re-leasing our property. If a lease is terminated, there is no assurance that we will be able to lease the property for the rent previously received or sell the property without incurring a loss.

Liability for uninsured losses could adversely affect our financial condition.

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

We could incur significant costs related to government regulation and private litigation over environmental matters.

Under various environmental laws, including the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), a current or previous owner or operator of real property may be liable for contamination resulting from the release or threatened release of hazardous or toxic substances or petroleum at that property, and an entity that arranges for the disposal or treatment of a hazardous or toxic substance or petroleum at another property may be held jointly and severally liable for the cost to investigate and clean up such property or other affected property. Such parties are known as potentially responsible parties ("PRPs"). Environmental laws often impose liability without regard to whether the owner or operator knew of, or was responsible for, the presence of the contaminants, and the costs of any required investigation or cleanup of these substances can be substantial. PRPs are liable to the government as well as to other PRPs who may have claims for contribution. The liability is generally not limited under such laws and could exceed the property’s value and the aggregate assets of the liable party. The presence of contamination or the failure to remediate contamination at our properties also may expose us to third-party liability for personal injury or property damage, or adversely affect our ability to sell, lease or develop the real property or to borrow using the real property as collateral.

Environmental laws also impose ongoing compliance requirements on owners and operators of real property. Environmental laws potentially affecting us address a wide variety of matters, including, but not limited to, asbestos-containing building materials, storage tanks, storm water and wastewater discharges, lead-based paint, wetlands and hazardous wastes. Failure to comply with these laws could result in fines and penalties and/or expose us to third-party liability. Some of our properties may have conditions that are subject to these requirements, and we could be liable for such fines or penalties and/or liable to third parties for those conditions.

We could be exposed to liability and remedial costs related to environmental matters.

Certain of our properties may contain, or may have contained, asbestos-containing building materials ("ACBMs"). Environmental laws require that ACBMs be properly managed and maintained and may impose fines and penalties on building owners and operators for failure to comply with these requirements. Also, certain of our properties may contain, or may have contained, or are adjacent to or near other properties that have contained or currently contain storage tanks for the storage of petroleum products or other hazardous or toxic substances. These operations create a potential for the release of petroleum products or other hazardous or toxic substances. Certain of our properties may contain, or may have contained, elevated radon levels. Third parties may be permitted by law to seek recovery from owners or operators for property damage and/or personal injury associated with exposure to contaminants, including, but not limited to, petroleum products, hazardous or toxic substances and asbestos fibers. Also, certain of our properties may contain regulated wetlands that can delay or impede development or require costs to be incurred to mitigate the impact of any disturbance. Absent appropriate permits, we can be held responsible for restoring wetlands and be required to pay fines and penalties.

Certain of our properties may contain, or may have contained, microbial matter such as mold and mildew. The presence of microbial matter could adversely affect our results of operations. In addition, if any of our property is not properly connected to a water or sewer system, or if the integrity of such systems are breached, or if water intrusion into our buildings otherwise occurs, microbial matter or other contamination can develop. When excessive moisture accumulates in buildings or on building materials, mold growth may occur, particularly if the moisture problem remains undiscovered or is not addressed over a period of time. Some molds may produce airborne toxins or irritants. If this were to occur, we could incur significant remedial costs and we may also be subject to material private damage claims and awards. Concern about indoor exposure to mold has been increasing, as exposure to mold may cause a variety of adverse health effects and symptoms, including allergic or other reactions. If we become subject to claims in this regard, it could materially and adversely affect us and our future insurability for such matters.

The assessments we perform on our acquisition of property may fail to reveal all environmental conditions, liabilities or compliance concerns. Material environmental conditions, liabilities or compliance concerns may have arisen after the assessments were conducted or may arise in the future, and future laws, ordinances or regulations may impose material additional environmental liability. We cannot assure you that costs of future environmental compliance will not affect our ability to make distributions or that such costs or other remedial measures will not be material to us.

Our properties may be subject to impairment charges, which could adversely affect our results of operations.

We are required to periodically evaluate our properties for impairment indicators. A property's value is considered impaired if management's estimate of the aggregate future cash flows (undiscounted and without interest charges) to be generated by the property, based upon its intended use, is less than the carrying value of the property. These estimates of cash flows are based upon factors such as expected future operating income, trends and prospects, as well as the effects of interest and capitalization rates, demand and occupancy, competition and other factors. These factors may result in uncertainty in valuation estimates and instability in the estimated value of our properties which, in turn, could result in a substantial decrease in the value of the properties and significant impairment charges.

We continually assess our properties to determine if any impairments are necessary or appropriate. No assurance can be given that we will be able to recover the current carrying amount of our properties in the future. Our failure to do so would require us to recognize additional impairment charges for the period in which we reached that conclusion, which could materially and adversely affect us and our results of operations. We recognized impairment charges of $6.8 million, $2.0 million, and $0.6 million during the years ended December 31, 2017, 2016, and 2015, respectively.

Mortgage loans may be affected by unfavorable real estate market conditions, including interest rate fluctuations, which could decrease the value of those loans and our results of operations.

Investments in mortgage loans, exposes us to the risk of default by the borrowers on those mortgage loans as well as interest rate risks. To the extent we incur delays in liquidating such defaulted mortgage loans, we may not be able to obtain sufficient proceeds to repay all amounts due to us under the mortgage loans. Further, we will not know whether the values of the properties securing the mortgage loans will remain at the levels existing on the dates of origination of those mortgage loans. If the values of the underlying properties fall, our risk will increase because of the lower value of the security associated with such loans. We do not have any mortgage loans currently outstanding.

Risks related to our financing

Capital markets and economic conditions can materially affect our financial condition and results of operations, the value of our equity securities, and our ability to sustain payment of distributions at current levels.

Many factors affect the value of our equity securities and our ability to make or maintain the current levels of distributions to stockholders, including the state of the capital markets and the economy. The availability of credit has been and may in the future again be adversely affected by illiquid credit markets. Regulatory pressures and the burden of troubled and uncollectible loans has led some lenders and institutional investors to reduce, and in some cases, cease to provide funding to borrowers. If these market conditions recur, they may limit our ability and the ability of our tenants to timely refinance maturing liabilities and access the capital markets to meet liquidity needs, which may materially affect our financial condition and results of operations and the value of our equity securities and our ability to sustain payment of distributions to stockholders at current levels.

Our Credit Facility contains various covenants which, if not complied with, could accelerate our repayment obligations, thereby materially and adversely affecting our liquidity, financial condition, results of operations and ability to pay distributions to stockholders.

The agreement governing our Credit Facility requires us to comply with certain financial and operational covenants. These covenants require us to, among other things, maintain certain financial ratios, including fixed charge coverage, debt service coverage and a minimum net worth. We are also required to limit our distributions to stockholders to 100% of our FFO. As of December 31, 2017, we were in compliance with these covenants. However, our continued compliance with these covenants depends on many factors, and could be impacted by current or future economic conditions, and thus there are no assurances that we will continue to comply with these covenants. Failure to comply with these covenants would result in a default which, if we were unable to obtain a waiver from the lenders, could accelerate our repayment obligations under the Credit Facility and thereby have a material adverse impact on our liquidity, financial condition, results of operations and ability to pay distributions to stockholders.

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Because our business strategy relies on external financing, we may be negatively affected by restrictions on additional borrowings, and the risks associated with leverage, including our debt service obligations.

We use leverage so that we may make more investments than would otherwise be possible in order to maximize potential returns to stockholders. Although we have been gradually reducing our overall leverage over the past few years to lower this risk, if the income generated by our properties and other assets fails to cover our debt service, we could be forced to reduce or eliminate distributions to our stockholders and may experience losses.

Our ability to achieve our investment objectives will be affected by our ability to borrow money in sufficient amounts and on favorable terms. We expect that we will primarily borrow money that will be secured by our properties and that these financing arrangements will contain customary covenants such as those that limit our ability, without the prior consent of the lender, to further mortgage the applicable property or to discontinue insurance coverage. Accordingly, we may be unable to obtain the degree of leverage we believe to be optimal, which may cause us to have less cash for distribution to stockholders than we would have with an optimal amount of leverage. Our use of leverage could also make us more vulnerable to a downturn in our business or the economy, as it may become difficult to meet our debt service obligations if our cash flows are reduced due to tenant defaults. There is also a risk that a significant increase in the ratio of our indebtedness to the measures of asset value used by financial analysts may have an adverse effect on the market price of our securities.

We face risks related to “balloon payments” and refinancing.

Some of our debt financing arrangements may require us to make lump-sum or “balloon” payments at maturity. Our ability to make a balloon payment at maturity is uncertain and may depend upon our ability to obtain additional financing or to sell the financed property. At the time the balloon payment is due, we may not be able to refinance the balloon payment on terms as favorable as the original loan or sell the property at a price sufficient to make the balloon payment, which could adversely affect the amount of distributions to our stockholders. We have balloon payments of $38.3 million payable during the remainder of 2018.

We mortgage our properties, which subjects us to the risk of foreclosure in the event of non-payment.

We intend to acquire additional properties by using our Credit Facility and by continuing to seek long-term financing, where we will borrow a portion of the purchase price of a potential acquisition and secure the loan with a mortgage on some or all of our existing real property. We look to regional banks, insurance companies and other non-bank lenders, and, to a lesser extent, the CMBS market to issue mortgages to finance our real estate activities. For the year ended December 31, 2017, we obtained approximately $62.4 million in long-term financing, which we used to acquire additional properties and refinance maturing debt. If we are unable to make our debt payments as required, a lender could foreclose on the property securing its loan. This could cause us to lose part or all of our investment in such property which in turn could cause the value of our securities or the amount of distributions to our stockholders to be reduced.

We face a risk from the fact that certain of our properties are cross-collateralized.

As of December 31, 2017, the mortgages on certain of our properties were cross-collateralized. To the extent that any of the properties in which we have an interest are cross-collateralized, any default by the property owner subsidiary under the mortgage note relating to the one property will result in a default under the financing arrangements relating to any other property that also provides security for that mortgage note or is cross-collateralized with such mortgage note.

A change in the value of our assets could cause us to experience a cash shortfall or be in default of our loan covenants.

We borrow on an unsecured basis under the Credit Facility; however, we are required to maintain a pool of unsecured assets sufficient to draw on the Credit Facility. A significant reduction in the value of our pool of unencumbered assets could require us to pay down a portion (or significant portion) of the balance of the Credit Facility. Although we believe that we have significant excess collateral and capacity, future asset values are uncertain. If we were unable to meet a request to add collateral to the Credit Facility, this inability could have a material adverse effect on our liquidity and our ability to meet our loan covenants.

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Interest rate fluctuations may adversely affect our results of operations.

We may experience interest rate volatility in connection with mortgage loans on our properties or other variable-rate debt that we may obtain from time to time. Certain of our leases contain escalations based on market interest rates and the interest rate on our Credit Facility and a portion of our long-term mortgages is variable. We have $69.3 million of outstanding principal on variable rate mortgages as of December 31, 2017. Although we seek to mitigate this risk by structuring such provisions to contain a maximum interest rate or escalation rate, as applicable, and generally obtain rate caps and interest rate swaps to limit our exposure to interest rate risk, these features or arrangements do not eliminate this risk. We are also exposed to the effects of interest rate changes as a result of holding cash and cash equivalents in short-term, interest-bearing investments. We have entered into interest rate caps to attempt to manage our exposure to interest rate fluctuations on all our outstanding variable rate mortgages. A significant change in interest rates could have an adverse impact on our results of operations.

Over the past year, the Federal Reserve has made gradual increases in the federal funds rate. These increases in the federal funds rate and any future increases due to other key economic indicators, such as the unemployment rate or inflation, may cause interest rates and borrowing costs to rise, which may negatively impact our ability to access the debt markets on favorable terms. Any prolonged adverse economic conditions could have a material adverse effect on our business, financial condition and results of operations.

Risks related to the real estate industry

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

Our investments include primarily industrial and office property. Our performance, and the value of our investments, is subject to risks inherent to the ownership and operation of these types of properties, including:

- changes in the general economic climate, including the credit market;
- changes in local conditions, such as an oversupply of space or reduction in demand for real estate;
- changes in interest rates and the availability of financing;
- competition from other available space;
- changes in laws and governmental regulations, including those governing real estate usage, zoning and taxes, and the related costs of compliance with laws and regulations; and
- variations in the occupancy rate of our properties.

The debt obligations of our tenants are dependent upon certain factors, which neither we nor our tenants or borrowers control, such as national, local and regional business and economic conditions, government economic policies, and the level of interest rates.

Competition for the acquisition of real estate may impede our ability to make acquisitions or increase the cost of these acquisitions.

We compete with many other entities to acquire properties, including financial institutions, institutional pension funds, other REITs, foreign real estate investors, other public and private real estate companies and private real estate investors. These competitors may prevent us from acquiring desirable properties, cause an increase in the price we must pay for real estate, have greater resources than we do, and be willing to pay more for certain assets or may have a more compatible operating philosophy with our acquisition targets. In particular, larger REITs may enjoy significant competitive advantages that result from, among other things, a lower cost of capital and enhanced operating efficiencies. Our competitors may also adopt transaction structures similar to ours or offer more substantial rent abatements, tenant improvements, early termination rights or below-market renewal options to retain tenants, which would decrease our competitive advantage in offering flexible transaction terms. In addition, the number of entities and the amount of funds competing for suitable investment properties may increase, resulting in increased demand and increased prices paid for these properties.

Our ownership of properties through ground leases exposes us to risks which are different than those resulting from our ownership of fee title to other properties.

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We have acquired an interest in four of our properties by acquiring a leasehold interest in the land underlying the property, and we may acquire additional properties in the future that are subject to similar ground leases. In this situation, we have no economic interest in the land underlying the property and do not control this land, thus this type of ownership interest poses potential risks for our business because (i) if the ground lease terminates for any reason, we will lose our interest in the property, including any investment that we made in the property, (ii) if our tenant defaults under the previously existing lease, we will continue to be obligated to meet the terms and conditions of the ground lease without the annual amount of ground lease payments reimbursable to us by the tenant, and (iii) if the third party owning the land under the ground lease disrupts our use either permanently or for a significant period of time, then the value of our assets could be impaired and our results of operations could be adversely affected.

Risks related to our Adviser

We are dependent upon our key personnel, who are employed by our Adviser, for our future success, particularly David Gladstone, Terry Lee Brubaker and Robert Cutlip.

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

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

Our ability to achieve our investment objectives and to pay distributions to our stockholders is dependent upon the performance of our Adviser in evaluating potential investments, selecting and negotiating property purchases and dispositions and mortgage loans, selecting tenants and borrowers, setting lease or mortgage loan terms and determining financing arrangements. Accomplishing these objectives on a cost-effective basis is largely a function of our Adviser’s marketing capabilities, management of the investment process, ability to provide competent, attentive and efficient services and our access to financing sources on acceptable terms. Our stockholders have no opportunity to evaluate the terms of transactions or other economic or financial data concerning our investments and must rely entirely on the analytical and management abilities of our Adviser and the oversight of our Board of Directors. If our Adviser or our Board of Directors makes inadvisable investment or management decisions, our operations could be materially adversely impacted. As we grow, our Adviser may be required to hire, train, supervise and manage new employees. Our Adviser’s failure to effectively manage our future growth could have a material adverse effect on our business, financial condition and results of operations.

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

Our Adviser manages our business and locates, evaluates, recommends and negotiates the acquisition of our real estate investments. At the same time, our Advisory Agreement permits our Adviser to conduct other commercial activities and provide management and advisory services to other entities, including, but not limited to, Gladstone Capital, Gladstone Investment, and Gladstone Land. Moreover, with the exception of our chief financial officer, treasurer and president, all of our executive officers and directors are also executive officers and directors of Gladstone Capital and Gladstone Investment, which actively make loans to and invest in lower middle market companies, and with the exception of our chief financial officer and president, all of our executive officers and directors are also officers and directors of Gladstone Land, an agricultural real estate investment trust. Further, our chief executive officer and chairman is on the board of managers of Gladstone Securities, an affiliated broker dealer that provides us with mortgage financing services pursuant to a contractual agreement. Mr. Gladstone is also the 100% indirect owner of and controls Gladstone Securities. As a result, we may from time to time have conflicts of interest with our Adviser in its management of our business, Gladstone Securities, in its provision of services to us and our other affiliated funds, and with Gladstone Capital, Gladstone Investment and Gladstone Land, which may arise primarily from the involvement of our Adviser, Gladstone Securities, Gladstone Capital, Gladstone Investment, Gladstone Land and their affiliates in other activities that may conflict with our business.

Examples of these potential conflicts include:

- our Adviser may realize substantial compensation on account of its activities on our behalf, and may, therefore, be motivated to approve acquisitions solely on the basis of increasing compensation to itself;
- our Adviser or Gladstone Securities, may earn fee income from our borrowers or tenants; and

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

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

Terminating the Advisory Agreement without cause requires payment of a substantial termination fee.

Termination of the Advisory Agreement with our Adviser without cause would be difficult and costly. We may only terminate the agreement without cause (as defined therein) upon 120 days' prior written notice and after the affirmative vote of at least two-thirds of our independent directors. Furthermore, if we default under the agreement and any applicable cure period has expired, the Adviser may terminate the agreement. In each of the foregoing cases, we will be required to pay the Adviser a termination fee equal to two times the sum of the average base management fee and incentive fee earned by our Adviser during the 24-month period prior to such termination. This provision increases the cost to us of terminating the Advisory Agreement and adversely affects our ability to terminate our Adviser without cause. Additionally, depending on the amount of the fee, if incurred, it could adversely affect our ability to pay distributions to our common, preferred and senior common stockholders.

Our Adviser is not obligated to provide a waiver of the incentive fee, which could negatively impact our earnings and our ability to maintain our current level of, or increase, distributions to our stockholders.

The Advisory Agreement contemplates a quarterly incentive fee based on our Core FFO (as defined in the Advisory Agreement). Our Adviser has the ability to issue a full or partial waiver of the incentive fee for current and future periods; however, our Adviser is not required to issue any waiver. Any waiver issued by our Adviser is a voluntary, unconditional and irrevocable waiver. For the years ended December 31, 2017 and 2016, our Adviser did not issue a full or partial waiver of the incentive fee. For the year ended December 31, 2015, an unconditional and irrevocable voluntary waiver was issued by our Adviser for approximately $2.5 million. If our Adviser does not issue this waiver in future quarters, it could negatively impact our earnings and may compromise our ability to maintain our current level of, or increase, distributions to our stockholders, which could have a material adverse impact on the market price of our securities.

Risks Related to Qualification and Operation as a REIT

If we fail to qualify as a REIT, our operations and distributions to stockholders would be adversely impacted.

We intend to continue to be organized and to operate to qualify as a REIT under the Internal Revenue Code of 1986, as amended (the "Code"). A REIT generally is not taxed at the corporate level on income it currently distributes to its stockholders. Qualification as a REIT involves the application of highly technical and complex rules for which there are only limited judicial or administrative interpretations. The determination of various factual matters and circumstances not entirely within our control may affect our ability to continue to qualify as a REIT. In addition, new legislation, new regulations, administrative interpretations or court decisions could significantly change the tax laws, possibly with retroactive effect, with respect to qualification as a REIT or the federal income tax consequences of such qualification.

If we were to fail to qualify as a REIT in any taxable year:

- we would not be allowed to deduct our distributions to stockholders when computing our taxable income;
-

we would be subject to federal income tax (including any applicable alternative minimum tax) on our taxable income at regular corporate rates;

- we would be disqualified from being taxed as a REIT for the four taxable years following the year during which qualification was lost, unless entitled to relief under certain statutory provisions;

- our cash available for distributions to stockholders would be reduced; and

- we may be required to borrow additional funds or sell some of our assets to pay corporate tax obligations that we may incur as a result of our disqualification.

We may need to incur additional borrowings to meet the REIT minimum distribution requirement and to avoid excise tax.

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In order to maintain our qualification as a REIT, we are required to distribute to our stockholders at least 90% of our annual real estate investment trust taxable income (excluding any net capital gain and before application of the distributions paid deduction). To the extent that we satisfy this distribution requirement, but distribute less than 100% of our taxable income, we will be subject to federal corporate income tax on our undistributed taxable income. In addition, we are subject to a 4% nondeductible excise tax on the amount, if any, by which certain distributions paid by us with respect to any calendar year are less than the sum of (i) 85% of our ordinary income for that year, (ii) 95% of our net capital gain for that year and (iii) 100% of our undistributed taxable income from prior years. In order to meet the 90% distribution requirement and to avoid the 4% excise tax, we may need to incur additional borrowings. Although we intend to pay distributions to our stockholders in a manner that allows us to meet the 90% distribution requirement and avoid this 4% excise tax, we cannot assure you that we will always be able to do so.

Complying with the REIT requirements may cause us to forgo otherwise attractive opportunities or liquidate otherwise attractive investments.

To qualify as a REIT for federal income tax purposes, we must continually satisfy tests concerning, among other things, the nature of our assets, the sources of our gross income, the amounts we distribute to our stockholders and the ownership of our capital stock. In order to meet these tests, we may be required to forgo investments we might otherwise make. Thus, compliance with the REIT requirements may hinder our performance.

In particular, we must ensure that at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and qualified real estate assets. The remainder of our investment in securities (other than government securities, securities of taxable REIT subsidiaries ("TRSs") and qualified real estate assets) generally cannot include more than 10% by voting power or vote of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our assets (other than government securities, securities of TRSs and qualified real estate assets) can consist of the securities of any one issuer, and no more than 25% (20% beginning with our taxable year ending December 31, 2018) of the value of our total assets can be represented by the securities of one or more TRSs.

We also must ensure that (i) at least 75% of our gross income for each taxable year consists of certain types of income that we derive, directly or indirectly, from investments relating to real property or mortgages on real property or qualified temporary investment income and (ii) at least 95% of our gross income for each taxable year consists of income that is qualifying income for purposes of the 75% gross income test, other types of interest and distributions, gain from the sale or disposition of stock or securities, or any combination of these.

In addition, we may be required to make distributions to our stockholders at disadvantageous times or when we do not have funds readily available for distribution. If we fail to comply with these requirements at the end of any calendar quarter, we must qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate otherwise attractive investments, and may be unable to pursue investments that would otherwise be advantageous to us in order to satisfy the asset and gross income requirements for qualifying as a REIT. These actions could have the effect of reducing our income and the amounts available for distribution to our stockholders. Thus, compliance with the REIT requirements may hinder our ability to make, and, in certain cases, maintain ownership of certain attractive investments.

To the extent that our distributions represent a return of capital for tax purposes, you could recognize an increased capital gain upon a subsequent sale of your stock.

Distributions in excess of our current and accumulated earnings and profits and not treated by us as a dividend will not be taxable to a U.S. stockholder to the extent such distributions do not exceed the stockholder’s adjusted tax basis in its shares of our stock but instead will constitute a return of capital and will reduce the stockholder’s adjusted tax basis in its share of our stock. If our distributions result in a reduction of a stockholder's adjusted basis in its shares of our stock, subsequent sales by such stockholder of its shares of our stock potentially will result in recognition of an increased capital gain or reduced capital loss due to the reduction in such stockholder's adjusted basis in its shares of our stock.

We may be subject to adverse legislative or regulatory tax changes that could reduce the market price of our securities.

At any time, the federal income tax laws governing REITs or the administrative interpretations of those laws may be amended. We cannot predict when or if any new federal income tax law, regulation, or administrative interpretation, or any amendment to any existing federal income tax law, regulation or administrative interpretation, will be adopted, promulgated or become effective and any such law, regulation, or interpretation may take effect retroactively. We and our stockholders could be adversely affected by any such change in, or any new, federal income tax law, regulation or administrative interpretation.

Complying with the REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.

The REIT provisions of the Code substantially limit our ability to hedge our liabilities. Any income from a hedging transaction that we enter into to manage risk of interest rate changes, price changes or currency fluctuations with respect to borrowings made or to be made to acquire or carry real estate assets does not constitute “gross income” for purposes of the gross income requirements. To the extent that we enter into other types of hedging transactions, the income from those transactions is likely to be treated as non-qualifying income for purposes of both of the gross income tests. As a result of these rules, we may need to limit our use of advantageous hedging techniques or implement those hedges through TRSs. This could increase the cost of our hedging activities because any TRS would be subject to tax on gains or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear. In addition, losses incurred by a TRS generally will not provide any tax benefit, except for being carried forward against future taxable income earned by the TRS.

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

As we hold all of the ownership interests in our Operating Partnership, it is currently disregarded for income tax purposes. We intend that our Operating Partnership will qualify as a partnership for income tax purposes upon the admission of additional partners; however, if the IRS were to successfully challenge the status of our Operating Partnership as a partnership, it would be taxable as a corporation. In such event, this would reduce the amount of distributions that our Operating Partnership could make to us. This could also result in our losing REIT status and becoming subject to corporate level tax on our income. This would substantially reduce our cash available to pay distributions and the return on your investment. In addition, if any of the entities through which our Operating Partnership owns its properties, in whole or in part, loses its characterization as a disregarded entity or a partnership for federal income tax purposes, it would be subject to taxation as a corporation, thereby reducing distributions to our Operating Partnership. Such a re-characterization of an underlying property owner could also threaten our ability to maintain REIT status.

Ownership limitations may restrict or prevent stockholders from engaging in certain transfers of our common stock.

Our charter contains an ownership limit which prohibits any person or group of persons from acquiring, directly or indirectly, beneficial or constructive ownership of more than 9.8% of our outstanding shares of capital stock. Shares owned by a person or a group of persons in excess of the ownership limit are deemed “excess shares.” Shares owned by a person who individually owns of record less than 9.8% of outstanding shares may nevertheless be excess shares if the person is deemed part of a group for purposes of this restriction.

If the transferee-stockholder acquires excess shares, the person is considered to have acted as our agent and holds the excess shares on behalf of the ultimate stockholder. When shares are held in this manner they do not have any voting rights and shall not be considered for purposes of any stockholder vote or determining a quorum for such vote.

Our charter stipulates that any acquisition of shares that would result in our disqualification as a REIT under the Code shall be void to the fullest extent permitted under applicable law.

The ownership limit does not apply to (i) offerers which, in accordance with applicable federal and state securities laws, make a cash tender offer, where at least 90% of the outstanding shares of our stock (not including shares or subsequently issued securities convertible into common stock which are held by the tender offerer and any “affiliates” or “associates” thereof within the meaning of the Exchange Act) are duly tendered and accepted pursuant to the cash tender offer; (ii) an underwriter in a public offering of our shares; (iii) a party initially acquiring shares in a transaction involving the issuance of our shares of capital stock, if our Board determines such party will timely distribute such shares such that, following such distribution, such shares will not be deemed excess shares; and (iv) a person or persons which our Board exempt from the ownership limit upon appropriate assurances that our qualification as a REIT is not jeopardized.

We operate as a holding company dependent upon the assets and operations of our subsidiaries, and because of our structure, we may not be able to generate the funds necessary to make dividend payments on our capital stock.

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We generally operate as a holding company that conducts its businesses primarily through our operating partnership, which in turn is a holding company conducting its business through its subsidiaries. These subsidiaries conduct all of our operations and are our only source of income. Accordingly, we are dependent on cash flows and payments of funds to us by our subsidiaries as dividends, distributions, loans, advances, leases or other payments from our subsidiaries to generate the funds necessary to make dividend payments on our capital stock. Our subsidiaries' ability to pay such dividends and/or make such loans, advances, leases or other payments may be restricted by, among other things, applicable laws and regulations, current and future debt agreements and management agreements into which our subsidiaries may enter, which may impair our ability to make cash payments on our common stock or our preferred stock. In addition, such agreements may prohibit or limit the ability of our subsidiaries to transfer any of their property or assets to us, any of our other subsidiaries or to third parties. Our future indebtedness or our subsidiaries' future indebtedness may also include restrictions with similar effects.

In addition, because we are a holding company, stockholders' claims will be structurally subordinated to all existing and future liabilities and obligations (whether or not for borrowed money) of our operating partnership and its subsidiaries. Therefore, in the event of our bankruptcy, liquidation or reorganization, claims of our stockholders will be satisfied only after all of our and our operating partnership's and its subsidiaries' liabilities and obligations have been paid in full.

Other risks

The number of shares of preferred stock outstanding may increase as a result of ATM Programs that we have in place for our Series A, B and D Preferred Stock, which could adversely affect our business, financial condition and results of operations.

The number of outstanding shares of preferred stock may increase as a result of the ATM Programs currently in place, for each of our Series A, B and D Preferred stock. The issuance of additional shares of Preferred Stock could have significant consequences on our future operations, including:

- making it more difficult for us to meet our payment and other obligations to holders of our preferred stock and under our Credit Facility and to pay dividends on our common stock;
- reducing the availability of our cash flow to fund acquisitions and for other general corporate purposes, and limiting our ability to obtain additional financing for these purposes; and
- limiting our flexibility in planning for, or reacting to, and increasing our vulnerability to, changes in our business, and adverse changes the industry in which we operate and the general economy.

Any of the above-listed factors could have an adverse effect on our business, financial condition and results of operations and our ability to meet our payment obligations under our Credit Facility and monthly dividend obligations with respect to our preferred stock and to pay dividends on our common stock.

We are subject to restrictions that may discourage a change of control. Certain provisions contained in our articles of incorporation and Maryland law may prohibit or restrict a change of control.

- Our articles of incorporation prohibit ownership of more than 9.8% of the outstanding shares of our capital stock by one person. This restriction may discourage a change of control and may deter individuals or entities from making tender offers for our capital stock, which offers might otherwise be financially attractive to our stockholders or which might cause a change in our management.

Our Board of Directors is divided into three classes, with the term of the directors in each class expiring every third year. At each annual meeting of stockholders, the successors to the class of directors whose term expires at such meeting will be elected to hold office for a term expiring at the annual meeting of stockholders held in the third year following the year of their election. After election, a director may only be removed by our stockholders for cause.

- Election of directors for staggered terms with limited rights to remove directors makes it more difficult for a hostile bidder to acquire control of us. The existence of this provision may negatively impact the price of our securities and may discourage third-party bids to acquire our securities. This provision may reduce any premiums paid to stockholders in a change in control transaction.

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

- any person who beneficially owns 10% or more of the voting power of our common stock, referred to as an "interested stockholder;"

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- an affiliate of ours who, at any time within the two-year period prior to the date in question, was an interested stockholder; or
- an affiliate of an interested stockholder.

These prohibitions last for five years after the most recent date on which the interested stockholder became an interested stockholder. Thereafter, any business combination with the interested stockholder must be recommended by our Board of Directors and approved by the affirmative vote of at least 80% of the votes entitled to be cast by holders of our outstanding shares of common stock and two-thirds of the votes entitled to be cast by holders of our common stock other than shares held by the interested stockholder. These requirements could have the effect of inhibiting a change in control even if a change in control were in our stockholders' interest. These provisions of Maryland law do not apply, however, to business combinations that are approved or exempted by our Board of Directors prior to the time that someone becomes an interested stockholder.

Market conditions could adversely affect the market price and trading volume of our securities

The market price of our common and preferred stock may be highly volatile and subject to wide fluctuations, and the trading volume in our common and preferred stock may fluctuate and cause significant price variations to occur. We cannot assure investors that the market price of our common and preferred stock will not fluctuate or decline further in the future. Some market conditions that could negatively affect our share price or result in fluctuations in the price or trading volume of our securities include, but are not limited to:

- price and volume fluctuations in the stock market from time to time, which are often unrelated to the operating performance of particular companies;
- significant volatility in the market price and trading volume of shares of REITs, real estate companies or other companies in our sector, which is not necessarily related to the performance of those companies;
- price and volume fluctuations in the stock market as a result of terrorist attacks, or speculation regarding future terrorist attacks, in the United States or abroad;
- actual or anticipated variations in our quarterly operating results or distributions to shareholders;
- changes in our FFO or earnings estimates or the publication of research reports about us or the real estate industry generally;
- actions by institutional stockholders;
- speculation in the press or investment community;
- changes in regulatory policies or tax guidelines, particularly with respect to REITs; and
- investor confidence in the stock market.

Shares of common and preferred stock eligible for future sale may have adverse effects on the respective share price.

We cannot predict the effect, if any, of future sales of common or preferred stock, or the availability of shares for future sales, on the market price of our common or preferred stock. Sales of substantial amounts of common or preferred stock (including shares of common stock issuable upon the conversion of units of our operating partnership that we may issue from time to time, issuable upon conversion of our Senior Common Stock, or issuances made through our ATM programs or otherwise), or the perception that these sales could occur, may adversely affect prevailing market prices for our common and preferred stock.

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Compliance or failure to comply with laws requiring access to our properties by disabled persons could result in substantial cost.

The Americans with Disabilities Act ("ADA"), and other federal, state and local laws generally require public accommodations be made accessible to disabled persons. Noncompliance could result in the imposition of fines by the government or the award of damages to private litigants. These laws may require us to modify our existing properties. These laws may also restrict renovations by requiring improved access to such buildings by disabled persons or may require us to add other structural features which increase our construction costs. Legislation or regulations adopted in the future may impose further burdens or restrictions on us with respect to improved access by disabled persons. We may incur unanticipated expenses that may be material to our financial condition or results of operations to comply with ADA and other federal, state and local laws, or in connection with lawsuits brought by private litigants.

Our Board of Directors may change our investment policy without stockholders' approval.

Subject to our co-investment policy, our Board of Directors will determine our investment and financing policies, growth strategy and our debt, capitalization, distribution, acquisition, disposition and operating policies. Our Board of Directors may revise or amend these strategies and policies at any time without a vote by stockholders. Accordingly, stockholders' control over changes in our strategies and policies is limited to the election of directors, and changes made by our Board of Directors may not serve the interests of stockholders and could adversely affect our financial condition or results of operations, including our ability to distribute cash to stockholders or qualify as a REIT.

Our rights and the rights of our stockholders to take action against our directors and officers are limited.

Maryland law provides that a director or officer has no liability in that capacity if he or she performs his or her duties in good faith, in a manner he or she reasonably believes to be advisable and in our best interests and with the care that an ordinarily prudent person in a like position would use under similar circumstances. In addition, our charter (i) eliminates our directors' and officers' liability to us and our stockholders for money damages except for liability resulting from actual receipt of an improper benefit in money, property or services or active and deliberate dishonesty established by a final judgment and that is material to the cause of action and (ii) requires us to indemnify directors and officers for liability resulting from actions taken by them in those capacities to the maximum extent permitted by Maryland law. As a result, our stockholders and we may have more limited rights against our directors and officers than might otherwise exist under common law. In addition, we may be obligated to fund the defense costs incurred by our directors and officers.

Our ability to pay distributions is limited by the requirements of Maryland law.

Our ability to pay distributions on our stock is limited by the laws of Maryland. Under applicable Maryland law, a Maryland corporation generally may not make a distribution if, after giving effect to the distribution, the corporation would not be able to pay its debts as the debts become due in the usual course of business or the corporation's total assets would be less than the sum of its total liabilities plus, unless the corporation's charter permits otherwise, the amount that would be needed, if the corporation were dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of stockholders whose preferential rights are superior to those receiving the distribution. Accordingly, we generally may not make a distribution on our stock if, after giving effect to the distribution, we would not be able to pay our debts as they become due in the usual course of business or our total assets would be less than the sum of our total liabilities plus, unless the terms of such class or series provide otherwise, the amount that would be needed to satisfy the preferential rights upon dissolution of the holders of shares of any class or series of stock then outstanding, if any, with preferences upon dissolution senior to those of such class of stock with respect to which the distribution would be made.

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Cybersecurity risks and cyber incidents may adversely affect our business by causing a disruption to our operations, or the operations of businesses in which we invest, a compromise or corruption of our confidential information and/or damage to our business relationships, all of which could negatively impact our business, financial condition and operating results.

In the normal course of business we and our service providers collect and retain certain personal information provided by our tenants, employees of our Administrator and Adviser, and vendors. We also rely extensively on computer systems to process transactions and manage our business. A cyber incident is considered to be any adverse event that threatens the confidentiality, integrity or availability of our information resources. These incidents may be an intentional attack or an unintentional event and could involve gaining unauthorized access to our information systems for purposes of misappropriating assets, stealing confidential information, corrupting data or causing operational disruption. The result of these incidents may include disrupted operations, misstated or unreliable financial data, liability for stolen assets or information, increased cybersecurity protection and insurance costs, litigation and damage to our business relationships. As our reliance on technology has increased, so have the risks posed to our information systems, both internal and those provided to us by third-party service providers. We have implemented processes, procedures and internal controls to help mitigate cybersecurity risks and cyber intrusions, but these measures, as well as our increased awareness of the nature and extent of a risk of a cyber-incident, do not guarantee that a cyber-incident will not occur and/or that our financial results, operations or confidential information will not be negatively impacted by such an incident.

Upcoming changes in U.S. Generally Accepted Accounting Principles regarding operating leases may make the leasing of our properties less attractive to prospective tenants, and reduce potential lease terms.

In February 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-02, "Leases: Amendments to the FASB Accounting Standards Codification" ("ASU 2016-02"). Under the new leasing standard, a lessee is required to record a right-of-use asset and a lease liability for all leases with a term greater than 12 months regardless of their classification. The upcoming standard is effective for fiscal years (and interim periods within those fiscal years) beginning after December 15, 2018, with early adoption permitted. The upcoming standard will affect lessee accounting for most current and prospective tenants. This standard may encourage current and prospective tenants to enter into shorter term leases, or acquire real estate, to lessen the impact to their balance sheets, both which would negatively impact our operations.

Legislative or regulatory tax changes related to REITs could materially and adversely affect us.

The U.S. federal income tax laws and regulations governing REITs and their stockholders, as well as the administrative interpretations of those laws and regulations, constantly are under review and may be changed at any time, possibly with retroactive effect. No assurance can be given as to whether, when, or in what form, the U.S. federal income tax laws applicable to us and our stockholders may be enacted. Changes to the U.S. federal income tax laws and interpretations of U.S. federal tax laws could adversely affect an investment in our stock.

On December 22, 2017, President Donald J. Trump signed into law P.L. 115-97, informally titled the Tax Cuts and Jobs Act (the "TCJA"). The TCJA makes significant changes to U.S. federal income tax laws applicable to businesses and their owners, including REITs and their stockholders, and may lessen the relative competitive advantage of operating as a REIT rather than as a corporation.

Certain key provisions of the TCJA that could impact us and our stockholders, beginning in 2018, include:

- temporary reduction of the U.S. federal income tax rates applicable to ordinary income of individuals; the highest individual U.S. federal income tax rate is reduced from 39.6% to 37% for taxable years beginning in 2018 through taxable year ending in 2025;

- reduction of the maximum corporate income tax rate from 35% to 21%;

- a new deduction for certain pass-through business income, including dividends received by our shareholders that are not designated by us as capital gain dividends or qualified dividend income, which will allow individuals, trusts, and estates to deduct up to 20% of such amounts, generally resulting in an effective maximum U.S. federal income tax rate of 29.6% on such dividends from us (through taxable years ending in 2025);

- reduction of the highest rate of withholding from 35% to 21% with respect to our distributions to non-U.S. stockholders that are treated as attributable to gains from the sale or exchange of U.S. real property interests;

- limitation of our deduction for net operating losses to 80% of taxable income (prior to the application of the dividends paid deduction);

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- limitation on the deduction of net interest expense, other than certain businesses that are eligible to elect out of such limitation; and

- elimination of the corporate alternative minimum tax.

Our stockholders should consult with their own tax advisors regarding the effects of the TCJA or other legislative, regulatory or administrative developments on their investment in our stock.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

As of December 31, 2017, we wholly-owned 99 properties, comprised of 11.5 million square feet of rentable space in 24 states. Our properties were 98.0% leased with an average remaining lease term of 7.6 years. See Schedule III - Real Estate and Accumulated Depreciation included elsewhere in this Annual Report on Form 10-K for a detailed listing of the properties in our portfolio.

The following table summarizes the lease expirations by year for our properties for leases in place as of December 31, 2017 (dollars in thousands):

Year of Lease Expiration	Square Feet (1)	Number of Expiring Leases	Rental Revenue for the year ended December 31, 2017	% Expiring
2018	8,275	1	$ 124	0.1 %
2019	659,797	6	3,726	4.0 %
2020	901,211	12	11,118	12.0 %
2021	550,782	13	8,331	9.0 %
2022	446,457	8	6,366	6.9 %
2023	1,460,802	13	10,045	10.8 %
2024+	7,191,409	54	51,085	55.0 %
Sold/terminated leases	N/A	N/A	2,016	2.2 %
	11,218,733	107	$ 92,811	100.0 %

(1) Our vacant square footage totaled 233,426 square feet as of December 31, 2017.
N/A - Not Applicable

The following table summarizes the geographic locations of our properties as of December 31, 2017, 2016, and 2015, respectively (dollars in thousands):

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State	Rental Revenue for the year ended December 31, 2017	% of Rental Revenue	Number of Leases for the year ended December 31, 2017	Rentable Square Feet for the year ended December 31, 2017	Rental Revenue for the year ended December 31, 2016	% of Rental Revenue	Number of Leases for the year ended December 31, 2016	Rentable Square Feet for the year ended December 31, 2016	Rental Revenue for the year ended December 31, 2015	% of Rental Revenue	Number of Leases for the year ended December 31, 2015	Rentable Square Feet for the year ended December 31, 2015
Texas	$ 15,191	16.4 %	12	1,050,294	$ 15,024	17.8 %	12	1,050,276	$ 14,302	17.7 %	12	1,050,276
Pennsylvania	10,975	11.8	9	2,068,740	6,822	8.1	7	1,708,724	6,629	8.2	6	1,605,390
Ohio	9,002	9.7	15	1,230,750	9,494	11.2	14	1,401,491	10,186	12.6	16	1,484,753
Florida	7,336	7.9	10	617,996	3,074	3.6	3	311,561	2,478	3.1	2	192,337
North Carolina	6,036	6.5	8	894,465	5,881	7.0	8	894,465	5,484	6.8	8	894,465
Georgia	4,649	5.0	6	269,555	4,770	5.6	6	269,083	3,592	4.4	6	269,083
South Carolina	4,612	5.0	2	424,683	4,612	5.5	2	424,683	4,488	5.5	2	424,683
Michigan	4,327	4.7	4	754,935	4,298	5.1	4	754,935	4,295	5.3	4	754,935
Utah	4,024	4.3	3	295,499	3,207	3.8	2	193,471	1,368	1.7	1	86,409
Minnesota	3,703	4.0	6	281,248	3,386	4.0	5	281,248	3,275	4.0	3	284,170
All Other States	22,956	24.7	32	3,563,994	23,930	28.3	35	3,809,401	24,795	30.7	37	3,992,953
	$ 92,811	100.0 %	107	11,452,159	$ 84,498	100.0 %	98	11,099,338	$ 80,892	100.0 %	97	11,039,454

The following table summarizes rental revenue by tenant industries for the years ended December 31, 2017, 2016 and 2015 (dollars in thousands):

	For the year ended December 31,					
	2017		2016		2015	
Industry Classification	Rental Revenue	Percentage of Rental Revenue	Rental Revenue	Percentage of Rental Revenue	Rental Revenue	Percentage of Rental Revenue
Telecommunications	$ 15,616	16.7 %	$ 13,733	16.3 %	$ 12,752	15.8 %
Healthcare	12,988	14.0	13,618	16.1	12,463	15.4
Automobile	11,178	12.0	10,546	12.5	10,542	13.0
Diversified/Conglomerate Services	10,465	11.3	7,915	9.4	4,716	5.8
Information Technology	5,995	6.5	3,314	3.9	1,368	1.7
Diversified/Conglomerate Manufacturing	4,840	5.2	4,710	5.6	4,301	5.3
Personal, Food & Miscellaneous Services	4,667	5.0	3,569	4.2	6,306	7.8
Electronics	4,293	4.6	4,330	5.1	4,672	5.8
Buildings and Real Estate	3,205	3.5	2,199	2.6	2,190	2.7
Banking	3,082	3.3	2,451	2.9	1,755	2.2
Chemicals, Plastics & Rubber	2,940	3.2	3,104	3.7	3,145	3.9
Personal & Non-Durable Consumer Products	2,657	2.9	2,629	3.1	2,628	3.2
Machinery	2,241	2.4	2,590	3.1	3,214	4.0
Childcare	2,221	2.4	2,221	2.6	2,221	2.7

Beverage, Food & Tobacco	2,103	2.3		2,103	2.5		2,479	3.1	
Containers, Packaging & Glass	1,812	2.0		2,717	3.2		2,086	2.6	
Printing & Publishing	1,322	1.4		1,563	1.8		1,559	1.9	
Education	656	0.7		656	0.8		656	0.8	
Home & Office Furnishings	530	0.6		530	0.6		530	0.7	
Oil & Gas	—	—		—	—		1,309	1.6	
Total	$92,811	100.0	%	$84,498	100.0	%	$80,892	100.0	%

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Item 3. Legal Proceedings.

We are not currently subject to any material legal proceedings, nor, to our knowledge, is any material legal proceeding threatened against us. However, from time to time we may be party to various litigation matters, typically involving ordinary course and routine claims incidental to our business, which we may not consider material.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is traded on the Nasdaq Global Select Market ("Nasdaq"), under the symbol “GOOD.” The following table reflects the range of the high and low sale prices of our common stock on Nasdaq and the distributions per common share for the years ended December 31, 2017 and 2016. Distributions to common stockholders are declared quarterly and paid monthly. Amounts presented represent the cumulative amount of the monthly common stock distributions declared and paid during such quarter.

	Price Range		
	High	Low	Distributions Per Common Share
2016			
3/31/2016	$16.61	$12.00	$ 0.375
6/30/2016	17.88	15.92	0.375
9/30/2016	19.15	16.84	0.375
12/31/2016	20.10	16.02	0.375
2017			
3/31/2017	$21.09	$19.07	$ 0.375
6/30/2017	23.35	19.70	0.375
9/30/2017	22.69	20.02	0.375
12/31/2017	23.29	20.67	0.375

Since inception in 2003, we have never reduced our per-share distributions nor have we missed payment of a scheduled distribution to our common stockholders. Our Board of Directors regularly evaluates our per share distribution payments as they monitor the capital markets and the impact that the economy has upon us. The decision whether to authorize and pay distributions on shares of our common stock in the future, as well as the timing, amount and composition of any such future distributions, will be at the sole and absolute discretion of our Board of Directors in light of conditions then existing, including our earnings, taxable income, FFO, financial condition, liquidity, capital requirements, debt maturities, the availability of capital, contractual prohibitions or other restrictions, applicable REIT and legal restrictions and general overall economic conditions and other factors. While the statements above concerning our distribution policy represent our current expectations, any actual distribution payable will be determined by our Board of Directors based upon the circumstances at the time of declaration and the actual number of common shares then outstanding, and any common distribution payable may vary from such expected amounts.

To qualify as a REIT, we are required to make ordinary dividend distributions to our common stockholders. The amount of these distributions must equal at least the sum of (A) 90% of our “REIT taxable income” (computed without regard to the dividends paid deduction and capital gain) and (B) 90% of the net income (after tax), if any, from foreclosure property.

For federal income tax purposes, our common distributions generally consist of ordinary income, capital gains, nontaxable return of capital or a combination of those items. Distributions that exceed our current and accumulated earnings and profits (calculated for tax purposes) constitute a return of capital rather than a dividend, which reduces a stockholder’s basis in its shares of stock and will not be taxable to the extent of the stockholder’s basis in its shares of our stock. To the extent a distribution exceeds the stockholder’s share of both our current and accumulated earnings and profits and the stockholder’s basis in its shares of our stock, that distribution will be treated as a gain from the sale or exchange of that stockholder’s shares of our stock. Every year, we notify stockholders of the taxability of distributions paid to stockholders during the preceding year.

A covenant in the agreement governing our Credit Facility requires us to, among other things, limit our distributions to stockholders to 100% of our FFO, and continued compliance with this covenant may require us to limit our distributions to stockholders in the future. For a discussion of our Credit Facility , including the financial and operating covenants required for us to access this source of financing, see “Risk Factors – Our Credit Facility contains various covenants which, if not complied with, could accelerate our repayment obligations, thereby materially and adversely affecting our liquidity, financial condition, results of operations and ability to pay distributions to stockholders” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Credit Facility ” herein.

As of February 5, 2018, there were 19,939 beneficial owners of our common stock.

The Company pays distributions on shares of Senior Common Stock in an amount equal to $1.05 per share per annum, declared daily and paid at the rate of $0.0875 per share per month. The Senior Common Stock is not traded on any exchange or automated quotation system.

As of February 5, 2018, there were 303 beneficial owners of our Senior Common Stock.

Sale of Unregistered Securities

We did not sell unregistered shares of stock during the fiscal year ended December 31, 2017.

Issuer Purchaser of Equity Securities

We did not purchase any of our equity securities in the fourth quarter ended December 31, 2017.

Stock Performance Graph

The following graph compares the cumulative stockholder return (assuming reinvestment of distributions) of our common stock with the Standard and Poor's 500 Index ("S&P 500") and the FTSE NAREIT All REIT Index ("FNAR"), which is a market capitalization-weighted index that includes all REITs that are listed on the New York Stock Exchange, the American Stock Exchange or the Nasdaq national market list. The stock performance graph assumes $100 was invested on December 31, 2012.

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	At December 31,					
	2012	2013	2014	2015	2016	2017
GOOD	$100.00	$108.49	$112.78	$105.12	$158.04	$177.63
S&P 500	100.00	132.39	150.51	152.59	170.84	208.14
FNAR	100.00	103.21	131.23	134.23	146.69	160.29

Item 6. Selected Financial Data.

The following selected financial data as of and for each of the fiscal years ended December 31, 2017, 2016, 2015, 2014 and 2013 is derived from our audited consolidated financial statements. The data should be read in conjunction with our consolidated financial statements and notes thereto, included elsewhere in this report, and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Item 7 of this report.

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	For the year ended December 31, (Dollars in Thousands, Except Per Share Amounts)				
	2017	2016	2015	2014	2013
Operating Data:					
Total operating revenue	$94,799	$86,372	$83,766	$73,756	$61,343
Total operating expenses	(68,337)	(55,595)	(50,965)	(57,406)	(32,823)
Other expense, net	(20,525)	(26,819)	(29,205)	(22,252)	(26,993)
Net income (loss)	$5,937	$3,958	$3,596	$(5,902)	$1,527
Dividends attributable to preferred stock	(9,890)	(6,645)	(4,094)	(4,094)	(4,094)
Dividends attributable to senior common stock	(986)	(1,011)	(1,007)	(542)	(300)
Net loss attributable to common stockholders	$(4,939)	$(3,698)	$(1,505)	$(10,538)	$(2,867)
Share and Per Share Data:					
Loss per weighted average common share - basic & diluted	$(0.19)	$(0.16)	$(0.07)	$(0.61)	$(0.22)
Weighted average common shares outstanding-basic & diluted	26,358,237	23,193,962	21,159,597	17,253,503	13,164,244
Cash dividends declared per common share	$1.50	$1.50	$1.50	$1.50	$1.50
Supplemental Data:					
Net loss attributable to common stockholders	$(4,939)	$(3,698)	$(1,505)	$(10,538)	$(2,867)
Add: Real estate depreciation and amortization	42,795	37,517	35,288	28,864	22,827
Add: Impairment charge	6,835	2,016	622	14,238	—
Less: Gain on sale of real estate, net	(3,993)	(242)	(1,538)	(1,240)	—
Funds from operations available to common stockholders (1)	$40,698	$35,593	$32,867	$31,324	$19,960
Balance Sheet Data:					
Real estate, held for use, before accumulated depreciation	$893,853	$821,749	$708,377	$722,565	$642,353
Total assets (2)	$928,454	$851,742	$827,184	$781,581	$683,685
Mortgage notes payable, net, term preferred stock, net, term loan facility, net & revolving credit facility, net (2)	$542,627	$509,395	$563,432	$534,886	$478,662
Total stockholders’ and mezzanine equity	$350,230	$310,620	$233,871	$217,672	$183,146
Total common shares outstanding	28,384,016	24,882,758	22,485,607	19,589,606	15,662,414

(1) The National Association of Real Estate Investment Trusts ("NAREIT"), developed FFO as a relevant non-GAAP supplemental measure of operating performance of an equity REIT, to recognize that income-producing real estate historically has not depreciated on the same basis determined under GAAP. FFO, as defined by NAREIT, is net income (computed in accordance with GAAP), excluding gains or losses from sales of property and impairment losses on property, plus depreciation and amortization of real estate assets, and after adjustments for unconsolidated partnerships and joint ventures. FFO does not represent cash flows from operating activities in accordance with GAAP, which, unlike FFO, generally reflects all cash effects of transactions and other events in the determination of net income and should not be considered an alternative to net income as an indication of our performance or to cash flows from operations as a measure of liquidity or ability to make distributions. Comparison of FFO, using the NAREIT definition, to similarly titled measures for other REITs may not necessarily be meaningful due to possible differences in the application of the NAREIT definition used by such REITs.

(2) We adopted ASU 2015-03, “Simplifying the Presentation of Debt Issuance Costs” (“ASU-2015-03”) during the year ended December 31, 2016, which 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. All periods presented have been adjusted retroactively.

FFO available to common stockholders is FFO adjusted to subtract preferred share and Senior Common Stock share distributions. We believe that net loss attributable to common stockholders is the most directly comparable GAAP measure to FFO available to common stockholders.

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

The following table provides a reconciliation of our FFO for the years ended December 31, 2017, 2016, 2015, 2014 and 2013 to the most directly comparable GAAP measure, net income (loss), and a computation of basic and diluted FFO per weighted average common share:

	For the twelve months ended December 31, (Dollars in Thousands, Except for Per Share Amounts)				
	2017	2016	2015	2014	2013
Calculation of basic FFO per share of common stock					
Net income (loss)	$5,937	$3,958	$3,596	$(5,902)	$1,527
Less: Distributions attributable to preferred and senior common stock	(10,876)	(7,656)	(5,101)	(4,636)	(4,394)
Net loss attributable to common stockholders	$(4,939)	$(3,698)	$(1,505)	$(10,538)	$(2,867)
Adjustments:					
Add: Real estate depreciation and amortization	42,795	37,517	35,288	28,864	22,827
Add: Impairment charge	6,835	2,016	622	14,238	—
Less: Gain on sale of real estate, net	(3,993)	(242)	(1,538)	(1,240)	—
FFO available to common stockholders - basic	$40,698	$35,593	$32,867	$31,324	$19,960
Weighted average common shares outstanding - basic	26,358,237	23,193,962	21,159,597	17,253,503	13,164,244
Basic FFO per weighted average share of common stock	$1.54	$1.53	$1.55	$1.82	$1.52
Calculation of diluted FFO per share of common stock					
Net income (loss)	$5,937	$3,958	$3,596	$(5,902)	$1,527
Less: Distributions attributable to preferred and senior common stock	(10,876)	(7,656)	(5,101)	(4,636)	(4,394)
Net loss attributable to common stockholders	$(4,939)	$(3,698)	$(1,505)	$(10,538)	$(2,867)
Adjustments:					
Add: Real estate depreciation and amortization	42,795	37,517	35,288	28,864	22,827
Add: Impairment charge	6,835	2,016	622	14,238	—
Add: Income impact of assumed conversion of senior common stock	986	1,011	1,007	542	300
Less: Gain on sale of real estate, net	(3,993)	(242)	(1,538)	(1,240)	—
FFO available to common stockholders plus assumed conversions	$41,684	$36,604	$33,874	$31,866	$20,260
Weighted average common shares outstanding - basic	26,358,237	23,193,962	21,159,597	17,253,503	13,164,244
Effect of convertible senior common stock	753,881	800,116	782,957	428,509	238,126
Weighted average common shares outstanding - diluted	27,112,118	23,994,078	21,942,554	17,682,012	13,402,370
	$1.54	$1.53	$1.54	$1.80 (2)	$1.51

Diluted FFO per weighted average share of common stock (1)					
Distributions declared per share of common stock	$ 1.50	$ 1.50	$ 1.50	$ 1.50	$ 1.50

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(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 year ended December 31, 2015, 2014 and 2013 by $0.04 per share, $0.03 per share, and $0.02 per share per share, respectively.

(2) Includes a $5.3 million gain on debt extinguishment as a result of our Roseville, Minnesota deed-in-lieu transaction during the year ended December 31, 2014.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following analysis of our financial condition and results of operations should be read in conjunction with our financial statements and the notes thereto contained elsewhere in this Form 10-K.

General

We are an externally-advised 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 office mortgage loans; however, we do not have any mortgage loans currently outstanding. 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 primarily for real estate having net leases with remaining terms of approximately seven to 15 years and built in rental rate increases. Under a net lease, the tenant is required to pay most or all operating, maintenance, repair and insurance costs and real estate taxes with respect to the leased property.

All references to annualized generally accepted accounting principles ("GAAP") rent are rents that each tenant pays in accordance with the terms of its respective lease reported evenly over the non-cancelable term of the lease.

As of February 14, 2018:

- we owned 99 properties totaling 11.5 million square feet of rentable space in 24 states;
- our occupancy rate was 97.9%;
- the weighted average remaining term of our mortgage debt was 6.5 years and the weighted average interest rate was 4.6%; and
- the average remaining lease term of the portfolio was 7.5 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. 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 most primary and secondary markets. This condition has led to a rise in construction activity for both office and industrial properties in many markets. Research reports from national firms reflect that the industrial supply and demand relationship still appears to be in equilibrium, but that office supply and demand in select markets may be moving toward some increased vacancy. Interest rates have been volatile and although interest rates are still relatively low, lenders have varied on their required spreads over the last several quarters and overall financing costs for fixed rate mortgages appear to be on the rise. 2017 year-end statistics from national research firms indicate that total investment sales volume was approximately 8-10% less than the volume recorded in 2016. These statistics reflect that investment sales volumes have dropped for the past two years compared to the preceding year.

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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 2016 vote in the United Kingdom to exit the European Union, and an apparent continuing global economic slowdown. The impact of the recent passage of tax reform in the United States is unknown at this time, although the lowering of the corporate tax rate should be beneficial. Finally, the continuing 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 expirations, re-financing upcoming loan maturities, and acquiring additional properties with associated long-term leases. Currently, we only have one fully vacant building, located in Tewksbury, Massachusetts, as well as two partially vacant buildings. Our fully vacant property is under contract to sell, which we expect to be completed during the first quarter of 2018.

We have one lease expiring in 2018, which accounts for 0.1% of rental revenue recognized during the year ended December 31, 2017, six leases expiring in 2019, which account for 4.0% of rental revenue recognized during the year ended December 31, 2017 and twelve leases expiring in 2020, which account for 12.0% of rental revenue recognized during the year ended December 31, 2017.

Our available vacant space at December 31, 2017 represents 2.0% of our total square footage and the annual carrying costs on the vacant space, including real estate taxes and property operating expenses, are approximately $0.6 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 financing. Our principal sources of financing generally include the issuance of equity securities, long-term mortgage loans secured by properties, borrowings under our Revolver, which matures on October 27, 2021, and our Term Loan, which matures on October 27, 2022. While lenders' credit standards have tightened, we continue to look to national and regional banks, insurance companies and non-bank lenders, in addition to the CMBS market, to issue mortgages to finance our real estate activities.

In addition to obtaining funds through borrowing, we were active in the equity markets during the year ended December 31, 2017. We completed an overnight offering of our common stock, and we have also issued shares of both common stock and Series D Preferred Stock through our ATM Programs, pursuant to our open market sale agreements with Cantor Fitzgerald, discussed in more detail below.

Recent Developments

2017 Sale Activity

During the year ended December 31, 2017, we continued to execute our capital recycling program, whereby we sold properties outside of our core markets and redeployed proceeds to either fund property acquisitions in our target secondary growth markets, or repay outstanding debt. We expect to continue to execute our capital recycling plan and sell non-core properties as reasonable disposition opportunities become available. During the year ended December 31, 2017, we sold four non-core properties and applied the proceeds towards outstanding debt and property acquisitions, which is summarized in the table below (dollars in thousands):

Aggregate Square Footage	Aggregate Sales Price	Aggregate Sales Costs	Aggregate Impairment Charge for	Aggregate Gain on Sale of

Sold			the Twelve Months Ended December 31, 2017	Real Estate, net
593,763	$ 30,302	$ 803	$ 3,999	$ 3,993

2017 Acquisition Activity

During the year ended December 31, 2017, we acquired seven properties, one located in Conshohocken, Pennsylvania, one located in Philadelphia, Pennsylvania, three properties located in Maitland, Florida, one property located in Columbus, Ohio and one property located in Salt Lake City, Utah, which are summarized below (dollars in thousands):

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Aggregate Square Footage	Weighted Average Lease Term	Aggregate Purchase Price	Acquisition Costs	Aggregate Annualized GAAP Rent	Aggregate Debt Issued or Assumed
871,038	10.1 Years	$ 132,157	$ 1,356 (1)	$ 15,507	$ 54,887

(1) We adopted ASU 2017-01, "Clarifying the Definition of a Business," effective October 1, 2016. As a result, we treated all of our 2017 acquisitions as asset acquisitions rather than business combinations. As a result of this treatment, we capitalized $1.4 million of acquisition costs that would otherwise have been expensed under business combination treatment.

2017 Leasing Activities

During the year ended December 31, 2017, we executed nine lease extensions and/or modifications, which are summarized below (dollars in thousands):

Aggregate Square Footage	Weighted Average Lease Term	Aggregate Annualized GAAP Rent	Aggregate Tenant Improvement	Aggregate Leasing Commissions
880,749	9.2 years (1)	$ 6,976	$ 1,264	$ 742

(1) Weighted average lease term is weighted according to the annualized GAAP rent earned by each lease. Our leases have terms ranging from 1 year to 11.25 years.

2017 Expansion Activity

During the year ended December 31, 2017, we completed a 75,000 square foot expansion of our existing industrial property in Vance, Alabama for a total project cost of $6.7 million. With the completion of the expansion, the lease term reset for a 10 year term, which has been included in the table above. We recognized rental income of $1.8 million, $1.2 million, and $1.2 million for the years ended December 31, 2017, 2016, and 2015, respectively.

2017 Financing Activity

During the year ended December 31, 2017, we repaid four mortgages collateralized by 10 properties, which are summarized below (dollars in thousands):

Aggregate Fixed Rate Debt Repaid	Weighted Average Interest Rate on Fixed Rate Debt Repaid
$ 41,077	6.25 %

Aggregate Variable Rate Debt Repaid	Weighted Average Interest Rate on Variable Rate Debt Repaid
$ 8,163	LIBOR + 2.50%

During the year ended December 31, 2017, we issued or assumed four mortgages, collateralized by seven properties, and drew an additional advance on an existing mortgage note, collateralized by one property, which are summarized below (dollars in thousands):

Aggregate Fixed Rate Debt Issued or Assumed		Weighted Average Interest Rate on Fixed Rate Debt		Aggregate Variable Rate Debt Issued or Assumed	
$54,887	(1)	3.78 %	(2)	$ 7,500	(3)

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(1) We issued or assumed $54.9 million of fixed rate, or swapped to fixed rate, debt in connection with five of our seven property acquisitions in 2017, with maturity dates ranging from April 1, 2026 to August 10, 2027.

(2) We assumed an interest rate swap in connection with one property acquisition and will be paying an all-in fixed rate of 3.55%. The newly issued fixed rate mortgages have rates ranging from 3.75% to 3.89%.

(3) The interest rate for our newly issued variable rate mortgage debt is equal to one month LIBOR plus a spread of 2.75%. The maturity date on this new variable rate debt is May 15, 2020. We have entered into a rate cap agreement on our new variable rate debt and will record all fair value changes into interest expense on the consolidated statement of operations and comprehensive income. The interest rate for our additional advance on the existing mortgage note is equal to one month LIBOR plus a spread of 2.50% and the maturity date is December 1, 2021.

On October 27, 2017, we amended our existing Credit Facility. The Term Loan component of the Credit Facility was increased from $25.0 million to $75.0 million, with the Revolver commitment remaining at $85.0 million. The Term Loan has a new five-year term, with a maturity date of October 27, 2022, and the Revolver has a new four-year term, with a maturity date of October 27, 2021. The interest rate for the Credit Facility was reduced by 25 basis points at each of the leverage tiers. We entered into interest rate cap agreements on the amended Term Loan, which cap LIBOR at 2.75%. We used the net proceeds of the amended Credit Facility to repay all previously existing borrowings under the Revolver. We incurred fees of approximately $0.9 million in connection with the Credit Facility amendment.

2017 Equity Activities

The equity issuances summarized below were issued under our universal shelf registration statement on Form S-3 (File No. 333-208953) ("Universal Shelf") that was effective and on file with the SEC at the time of each respective issuance.

Common Stock Offering

On July 25, 2017, we completed an overnight offering of 1.2 million shares of our common stock at a public offering price of $20.52 per share. Net proceeds, after deducting underwriter commissions and discounts, were $22.5 million. The proceeds from this offering were used to acquire real estate, repay existing indebtedness and for other general corporate purposes. On July 31, 2017, the offering's underwriters also exercised their overallotment option, purchasing an additional 0.2 million shares of our common stock at the public offering price of $20.52 per share. Net proceeds from this exercise, after deducting underwriter commissions and discounts, were $3.4 million. The proceeds from this overallotment were also used to acquire real estate, repay existing indebtedness, and for other general corporate purposes.

Common Stock ATM Program

In February 2016, we amended our common stock ATM program with Cantor Fitzgerald (the “Common Stock ATM Program”). The amendment increased the amount of shares of common stock that we may offer and sell through Cantor Fitzgerald to $160.0 million. All other material terms of the Common Stock ATM program remained unchanged. During the year ended December 31, 2017, we sold 2.1 million shares of common stock, raising $45.5 million in net proceeds under the program. As of December 31, 2017, we had a remaining capacity to sell up to $86.3 million of common stock under the program. The proceeds from these issuances were used to acquire real estate, repay outstanding debt and for other general corporate purposes.

Series A and B Preferred Stock ATM Programs

In February 2016, we entered into an open market sales agreement with Cantor Fitzgerald (the “Series A and B Preferred ATM Program”), pursuant to which we may, from time to time, offer to sell (i) shares of our 7.75% Series A Cumulative Redeemable Preferred Stock (“Series A Preferred”), and (ii) shares of our 7.50% Series B Cumulative Redeemable Preferred Stock (“Series B Preferred”), having an aggregate offering price of up to $40.0 million, through Cantor Fitzgerald, acting as sales agent and/or principal. We did not sell any shares of our Series A Preferred or Series B Preferred during the year ended December 31, 2017. As of December 31, 2017, we had a remaining capacity to sell up to $37.2 million of preferred stock under the Series A and B Preferred ATM Program.

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Mezzanine Equity

Our 7.00% Series D Cumulative Redeemable Preferred Stock (“Series D Preferred”), is classified as mezzanine equity in our 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. A change in control of our company, outside of our control, is only possible if a tender offer is accepted by over 90% of our shareholders. All other change in control situations would require input from our Board of Directors. We will periodically evaluate the likelihood that a change of control of 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 of greater than 50% is remote.

In June 2016, we entered into an open market sales agreement with Cantor Fitzgerald (the “Series D Preferred ATM Program”), 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. During the year ended December 31, 2017, we sold 0.5 million shares of our Series D Preferred Stock for net proceeds of $12.7 million. As of December 31, 2017, we had a remaining capacity to sell up to $20.8 million of Series D Preferred Stock under the Series D Preferred ATM Program. The proceeds from these issuances were used to acquire real estate, repay outstanding debt and for other general corporate purposes.

Amendment to Articles of Incorporation

On January 11, 2017, we filed with the Maryland State Department of Assessments and Taxation an Articles Supplementary reclassifying the remaining 160,000 authorized but unissued shares of our Series C Preferred Stock, as authorized but unissued shares of our common stock, and made a corresponding amendment to our Partnership Agreement with regard to corresponding units of partnership interest. As a result of the reclassification, there are zero authorized shares of Series C Preferred Stock and zero authorized corresponding units of partnership interest remaining. On the same date, we filed with the Maryland State Department of Assessments and Taxation an Articles of Restatement, restating and integrating into a single instrument all prior Articles Supplementary and amendments thereto.

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. The Administrator employs our chief financial officer, treasurer, chief compliance officer, and general counsel and secretary (who also serves as our Administrator’s president, general counsel, and secretary) and their respective staffs.

Our Adviser and Administrator also provide investment advisory and administrative services, respectively, to certain of our affiliates, including, but not limited to, Gladstone Capital and Gladstone Investment, both publicly-traded business development companies, as well as Gladstone Land, a publicly-traded REIT that primarily invests in farmland. With the exception of Mr. Michael Sodo, 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 and Gladstone Investment. In addition, with the exception of

Mr. Cutlip, and Mr. Sodo, all of our executive officers and all of our directors, serve as either directors or executive officers, or both, of Gladstone Land. Mr. Cutlip and Mr. Sodo spend 100% of their time focused on Gladstone Commercial, and do not put forth any material efforts in assisting affiliated companies. In the future, our Adviser may provide investment advisory services to other companies, both public and private.

Advisory and Administration Agreements

Many of the services performed by our Adviser and Administrator in managing our day-to-day activities are summarized below. This summary is provided to illustrate the material functions which our Adviser and Administrator perform for us pursuant to the terms of the Advisory and Administration Agreements, respectively.

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Advisory 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, 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).

Base Management Fee

On January 10, 2017, we entered into a Fourth Amended and Restated Investment Advisory Agreement with the Adviser, effective as of October 1, 2016. Our entrance into the Advisory Agreement and each amendment was approved unanimously by our Board of Directors. Our Board of Directors reviews and considers renewing the agreement with our Adviser each July. During its July 2017 meeting, our Board of Directors reviewed and renewed the Advisory Agreement for an additional year, through August 31, 2018.

Under the Advisory Agreement, the calculation of the annual base management fee equals 1.5% of our adjusted total stockholders' equity, which is our total stockholders' equity plus total mezzanine 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. Our Adviser does not charge acquisition or disposition fees when we acquire or dispose of properties as is common in other externally managed REITs; however, our Adviser may earn fee income from our borrowers, tenants or other sources.

Incentive Fee

Pursuant to the Advisory Agreement, the calculation of the incentive fee rewards 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 exceeded 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 (as defined in the Advisory Agreement) is 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 prior to the July 2015 amendment rewarded the Adviser in circumstances where our quarterly funds from operations, or 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. FFO included any realized capital gains and capital losses, less any distributions paid on preferred stock and Senior Common Stock (defined herein), 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.

Capital Gain Fee

Under the Advisory Agreement, 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 Advisory 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 years ended December 31, 2017, 2016, and 2015. As a result of the January 2017 amendment to the advisory agreement, the calculation of the capital gains fee is based on the all-in acquisition cost of disposed of properties. The impact of this amendment would not have resulted in capital gains fee for previously reported periods.

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Termination Fee

The 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

Under the terms of the Administration Agreement, we pay separately for our allocable portion of our Administrator's overhead expenses in performing its obligations to us including, but not limited to, rent and our allocable portion of the salaries and benefits expenses of our Administrator's employees, including, but not limited to, our chief financial officer, treasurer, chief compliance officer, general counsel and secretary (who also serves as our Administrator's president, general counsel and secretary), and their respective staffs. As approved by our Board of Directors, effective July 1, 2014, our allocable portion of the Administrator's expenses are 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. We believe that the methodology of allocating the Administrator's total expenses by approximate percentage of time services were performed among all companies serviced by our Administrator more closely approximates fees paid to actual services performed.

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, "Organization, Basis of Presentation and Significant Accounting Policies," to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K, as well as a summary of recently issued accounting pronouncements and their expected impact to our current and future financial statements. There were no material changes to our critical accounting policies during the year ended December 31, 2017; however we issued mezzanine equity during the year ended December 31, 2017, which is further described in Note 10, "Stockholders' Equity and Mezzanine Equity", of the accompanying consolidated financial statements and we adopted ASU 2017-01, effective October 1, 2016, which is described in more detail in Note 1 of the accompanying consolidated financial statements.

Allocation of Purchase Price

When we acquire real estate with an existing lease, we allocate the purchase price to (i) the acquired tangible assets and liabilities, consisting of land, building, tenant improvements and long-term debt and (ii) the identified intangible assets and liabilities, consisting of the value of above-market and below-market leases, in-place leases, unamortized lease origination costs, tenant relationships and capital lease obligations. We adopted ASU 2017-01 and effective October 1, 2016, we allocate the fair values in accordance with ASC 360, Property Plant and Equipment. All expenses related to the acquisition are capitalized and allocated among the identified assets. Prior to October 1, 2016, we allocated the fair values in accordance with ASC 805, Business Combinations, where all expenses related to the acquisition were expensed as incurred. We anticipate a majority of our property acquisitions will be considered asset acquisitions rather than business combinations, which will result in most acquisition expenses being capitalized, rather than expensed.

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Our Adviser estimates value using methods similar to those used by independent appraisers (e.g., discounted cash flow analysis). Factors considered by management in its analysis include an estimate of carrying costs during hypothetical expected lease-up periods, considering current market conditions and costs to execute similar leases. Our Adviser also considers information obtained about each property as a result of our pre-acquisition due diligence, marketing and leasing activities in estimating the fair value of the tangible and intangible assets and liabilities acquired. In estimating carrying costs, management also includes real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the hypothetical expected lease-up periods, which primarily range from nine to 18 months, depending on specific local market conditions. Our Adviser also estimates costs to execute similar leases, including leasing commissions, legal and other related expenses to the extent that such costs are not already incurred in connection with a new lease origination as part of the transaction. Our Adviser also considers the nature and extent of our existing business relationships with the tenant, growth prospects for developing new business with the tenant, the tenant's credit quality and management's expectations of lease renewals (including those existing under the terms of the lease agreement), among other factors. A change in any of the assumptions above, which are very subjective, could have a material impact on our results of operations.

The allocation of the purchase price directly affects the following in our consolidated financial statements:

- The amount of purchase price allocated to the various tangible and intangible assets and liabilities on our balance sheet;

- The amounts allocated to the value of above-market and below-market lease values are amortized to rental income over the remaining non-cancelable terms of the respective leases. The amounts allocated to all other tangible and intangible assets are amortized to depreciation or amortization expense. Thus, depending on the amounts allocated between land and other depreciable assets, changes in the purchase price allocation among our assets could have a material impact on our FFO, a metric which is used by many REIT investors to evaluate our operating performance; and

- The period of time over which tangible and intangible assets are depreciated varies greatly, and thus, changes in the amounts allocated to these assets will have a direct impact on our results of operations. Intangible assets are generally amortized over the respective life of the leases, which normally range from 10 to 15 years. Also, we depreciate our buildings over up to 39 years, but do not depreciate our land. These differences in timing could have a material impact on our results of operations.

Asset Impairment Evaluation

We periodically review the carrying value of each property to determine if circumstances that indicate impairment in the carrying value of the investment exist or that depreciation periods should be modified. In determining if impairment exists, our Adviser considers such factors as our tenants' payment histories, the financial condition of our tenants, including calculating the current leverage ratios of tenants, the likelihood of lease renewal, business conditions in the industries in which our tenants operate, whether the fair value of our real estate has decreased and whether our hold period has shortened. If any of the factors above indicate the possibility of impairment, we prepare a projection of the undiscounted future cash flows, without interest charges, of the specific property and determine if the carrying amount of such property is recoverable. In preparing the projection of undiscounted future cash flows, we estimate cap rates using information that we obtain from market comparability studies and other comparable sources, and apply the undiscounted cash flows against our expected holding period. If impairment were indicated, the carrying value of the property would be written down to its estimated fair value based on our best estimate of the property's discounted future cash flows using market derived cap rates applied against our expected hold period. Any material changes to the estimates and assumptions used in this analysis could have a significant impact on our results of operations, as the changes would impact our determination of whether impairment is deemed to have occurred and the amount of impairment loss that we would recognize.

Using the methodology discussed above, we evaluated our entire portfolio as of December 31, 2017, for any impairment indicators and performed an impairment analysis on those select properties that had an indication of impairment. We recognized impairment charges of $6.8 million on three of our properties during the year ended December 31, 2017. Two of these impaired properties were sold during the year ended December 31, 2017, and one of the impaired properties is classified as held for sale as of December 31, 2017.

We will continue to monitor our portfolio for any other indicators of impairment.

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Results of Operations

The weighted average yield on our total portfolio, which was 8.6% at December 31, 2017 and 2016, respectively, is calculated by taking the annualized straight-line rents, reflected as rental income on our consolidated statements of operations, of each acquisition 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 or other types of existing indebtedness.

A comparison of our operating results for the year ended December 31, 2017 and 2016 is below (dollars in thousands, except per share amounts):

	For the year ended December 31,			
	2017	2016	$ Change	% Change
Operating revenues				
Rental revenue	$92,811	$84,498	$8,313	9.8 %
Tenant recovery revenue	1,988	1,489	499	33.5 %
Interest income from mortgage note receivable	—	385	(385)	(100.0)%
Total operating revenues	94,799	86,372	8,427	9.8 %
Operating expenses				
Depreciation and amortization	42,795	37,517	5,278	14.1 %
Property operating expenses	7,688	5,889	1,799	30.5 %
Base management fee	4,959	3,930	1,029	26.2 %
Incentive fee	2,422	2,381	41	1.7 %
Administration fee	1,272	1,474	(202)	(13.7)%
General and administrative	2,366	2,388	(22)	(0.9)%
Impairment charge	6,835	2,016	4,819	239.0 %
Total operating expenses	68,337	55,595	12,742	22.9 %
Other (expense) income				
Interest expense	(24,570)	(25,902)	1,332	(5.1)%
Distributions attributable to Series C mandatorily redeemable preferred stock	—	(1,502)	1,502	(100.0)%
Gain (loss) on sale of real estate, net	3,993	242	3,751	1,550.0 %
Other income	52	343	(291)	(84.8)%
Total other expense, net	(20,525)	(26,819)	6,294	(23.5)%
Net income	5,937	3,958	1,979	50.0 %
Distributions attributable to Series A, B and D preferred stock	(9,890)	(6,645)	(3,245)	48.8 %
Distributions attributable to senior common stock	(986)	(1,011)	25	(2.5)%
Net loss attributable to common stockholders	$(4,939)	$(3,698)	$(1,241)	33.6 %
Net loss attributable to common stockholders per weighted average share of common stock - basic & diluted	$(0.19)	$(0.16)	$(0.03)	18.8 %
FFO available to common stockholders - basic	$40,698	$35,593	$5,105	14.3 %
FFO available to common stockholders - diluted	$41,684	$36,604	$5,080	13.9 %
Loss per weighted average share of common stock - basic & diluted	$(0.19)	$(0.16)	$(0.03)	18.8 %
FFO per weighted average share of common stock - basic	$1.54	$1.53	$0.01	0.7 %
FFO per weighted average share of common stock - diluted	$1.54	$1.53	$0.01	0.7 %

Same Store Analysis

For the purposes of the following discussion, same store properties are properties we owned as of January 1, 2016, which have not been subsequently vacated or disposed. Acquired and disposed properties are properties which were either acquired, disposed of or classified as held for sale at any point subsequent to December 31, 2015. Properties with vacancy are properties that were fully vacant or had greater than 5% vacancy, based on square footage, at any point subsequent to January 1, 2016.

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Operating Revenues

	For the year ended December 31, (Dollars in Thousands)			
Rental Revenues	2017	2016	$ Change	% Change
Same Store Properties	$74,125	$74,335	$(210)	(0.3)%
Acquired & Disposed Properties	13,098	5,854	7,244	123.7 %
Properties with Vacancy	3,785	3,136	649	20.7 %
Expanded Properties	1,803	1,173	630	53.7 %
	$92,811	$84,498	$8,313	9.8 %

Rental revenue from same store properties decreased slightly for the year ended December 31, 2017, primarily due to a reduction in rental rates from lease modifications on certain leases, and reduced rental income resulting from certain leases ending and new tenants absorbing vacant space. Rental revenue increased for acquired and disposed of properties for the year ended December 31, 2017, as compared to the year ended December 31, 2016, because we acquired seven properties during the year ended December 31, 2017, and we included a full year of rental revenue recorded in 2017 for three properties acquired during the year ended December 31, 2016, offset by a decrease in rental revenue from the four properties we sold during 2017. Rental revenue increased for properties with vacancy, as we were able to successfully lease previously vacant space in these properties. Rental revenue increased for expanded properties, as we completed our expansion project, resulting in additional rental charges.

	For the year ended December 31, (Dollars in Thousands)			
Tenant Recovery Revenue	2017	2016	$ Change	% Change
Same Store Properties	$1,510	$1,405	$ 105	7.5 %
Acquired & Disposed Properties	416	56	360	642.9 %
Properties with Vacancy	52	19	33	173.7 %
Expanded Properties	10	9	1	11.1 %
	$1,988	$1,489	$ 499	33.5 %

The increase in same store tenant recovery revenues for the year ended December 31, 2017, as compared to the year ended December 31, 2016, is a result of increased recoveries from tenants subject to base year leases, where we are reimbursed by the tenant for expenses incurred above the defined base year, coupled with recoveries resulting from capital improvement projects, which are amortized to the tenant. The increase in tenant recovery revenues on acquired and disposed of properties for the year ended December 31, 2017, as compared to the year ended December 31, 2016, is a result of recovery revenues on the seven properties we acquired during the year ended December 31, 2017, a majority of which are subject to base year leases.

Interest income from mortgage notes receivable decreased for the year ended December 31, 2017, as compared to the year ended December 31, 2016, because of interest earned on mortgage development loans that were outstanding during the year ended December 31, 2016, which were repaid with an exit fee in January 2016.

Operating Expenses

Depreciation and amortization increased for the year ended December 31, 2017 as compared to the year ended December 31, 2016, primarily due to recognizing a full year of depreciation for the three properties acquired during the year ended December 31, 2016, as well as increased depreciation expense from the seven properties acquired during the year ended December 31, 2017, partially offset by a lack of depreciation expense for the four properties sold during the year ended December 31, 2017.

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Property Operating Expenses	For the year ended December 31, (Dollars in Thousands) 2017	2016	$ Change	% Change
Same Store Properties	$4,815	$4,917	$(102)	(2.1)%
Acquired & Disposed Properties	2,323	354	1,969	556.2 %
Properties with Vacancy	529	596	(67)	(11.2)%
Expanded Properties	21	22	(1)	(4.5)%
	$7,688	$5,889	$1,799	30.5 %

Property operating expenses consist of franchise taxes, management fees, insurance, ground lease payments, property maintenance and repair expenses paid on behalf of certain of our properties. The decrease in property operating expenses for same store properties for the year ended December 31, 2017, as compared to the year ended December 31, 2016, is primarily a result of us incurring fewer landlord obligation expenses at certain of our properties with expense caps. The increase in property operating expenses on acquired and disposed of properties for the year ended December 31, 2017, as compared to the year ended December 31, 2016, is a result of recovery revenues on the seven properties we acquired during the year ended December 31, 2017, a majority of which are subject to base year leases.

The base management fee paid to the Adviser increased for the year ended December 31, 2017, as compared to the year ended December 31, 2016, due to an increase in total stockholder's equity plus mezzanine equity, the main components of the base management fee calculation. The calculation of the base management fee is described in detail above within “Advisory and Administration Agreements.”

The incentive fee paid to the Adviser increased for the year ended December 31, 2017, as compared to the year ended December 31, 2016, because of an increase in pre-incentive fee FFO. The increase in pre-incentive fee FFO was primarily due to an increase in rental revenues from the seven properties acquired during the year ended December 31, 2017, coupled with a full year of rental revenues from the properties acquired during the year ended December 31, 2016, partially offset by an increase in property operating expenses resulting from our lease portfolio containing additional base year leases. The calculation of the incentive fee is described in detail above within “Advisory and Administration Agreements.”

The administration fee paid to the Administrator decreased for the year ended December 31, 2017, as compared to the year ended December 31, 2016. The decrease is a result of the Company using a lesser share of the Administrator's resources for the year ended December 31, 2017, as compared to the year ended December 31, 2016. The calculation of the administration fee is described in detail above within “Advisory and Administration Agreements.”

General and administrative expenses decreased slightly for the year ended December 31, 2017, as compared to the year ended December 31, 2016, primarily as a result of a decrease in due diligence expenses due to our adoption of ASU 2017-01 “Clarifying the Definition of a Business,” which results in the capitalization of due diligence expenses in connection with property acquisitions coupled with a decrease in shareholder related expenses, partially offset by an increase in professional fees, and an increase in professional service subscriptions.

The impairment charge recognized during the year ended December 31, 2017 is a result of the impairments we recognized at three of our properties. As a result of our quarterly impairment testing performed during the 2017 fiscal year, we determined the carrying value of our Concord Township, Ohio, Newburyport, Massachusetts, and Tewksbury, Massachusetts properties were unrecoverable. Both the Concord Township, Ohio property and the Newburyport, Massachusetts property were sold during the year ended December 31, 2017. We had executed a sales contract to sell our fully vacant Tewksbury, Massachusetts property, resulting in an impairment of $2.8 million when we classified the property as held for sale at December 31, 2017. These properties were located in non-core markets, and we sold or are planning to sell them to generate funds for acquisitions in our target growth markets. The impairment charge recognized during the year ended December 31, 2016 was a result of the impairment of seven properties which were classified as held for sale at various points during the year ended December 31, 2016, and we impaired the properties as the fair value less selling costs was below the carrying value. We subsequently sold five of the properties during the year ended December 31, 2016, one of the properties during the year ended December 31, 2017, and one of the properties was classified as held and used in the consolidated balance sheet at December 31, 2016, and was sold during the year ended December 31, 2017.

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Other Income and Expenses

Interest expense decreased for the year ended December 31, 2017, as compared to the year ended December 31, 2016. This decrease was primarily a result of interest savings on mortgage debt repaid and refinanced at lower interest rates over the past 12 months coupled with reduced interest expense on our long-term financings from amortizing and balloon principal payments made during the past 12 months. Our weighted average interest rate for all debt is 4.42% at December 31, 2017, as compared to 4.48% at December 31, 2016.

Distributions attributable to our Series C Preferred Stock were eliminated, and thus decreased, during the year ended December 31, 2017, as compared to the year ended December 31, 2016, because we fully redeemed these shares during the year ended December 31, 2016.

The net gain on sale of real estate during the year ended December 31, 2017 is a result of the sale of four of our properties. The gain on sale of real estate during the year ended December 31, 2016 was a result of the sale of six of our properties.

Other income decreased during the year ended December 31, 2017, as compared to the year ended December 31, 2016, because of settlement proceeds received at one of our properties during the year ended December 31, 2016.

Net Loss Attributable to Common Stockholders

Net loss attributable to common stockholders increased for the year ended December 31, 2017, as compared to the year ended December 31, 2016, primarily because of the impairment charges recognized on three of our properties coupled with increased depreciation and amortization expense from our acquisitions during the year ended December 31, 2017 and increases to base management and incentive fees, offset by decreases in interest expense, decreases in distributions attributable to our Series C mandatorily redeemable preferred stock due to our redemption of these shares during the year ended December 31, 2016 and our gain on sale of real estate, net.

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A comparison of our operating results for the years ended December 31, 2016 and 2015 is below (dollars in thousands, except per share amounts):

	For the year ended December 31,			
	2016	2015	$ Change	% Change
Operating revenues				
Rental revenue	$84,498	$80,892	$3,606	4.5 %
Tenant recovery revenue	1,489	1,753	(264)	(15.1)%
Interest income from mortgage note receivable	385	1,121	(736)	(65.7)%
Total operating revenues	86,372	83,766	2,606	3.1 %
Operating expenses				
Depreciation and amortization	37,517	35,288	2,229	6.3 %
Property operating expenses	5,889	5,296	593	11.2 %
Base management fee	3,930	3,474	456	13.1 %
Incentive fee	2,381	4,650	(2,269)	(48.8)%
Administration fee	1,474	1,419	55	3.9 %
General and administrative	2,388	2,716	(328)	(12.1)%
Impairment charge	2,016	622	1,394	224.1 %
Total operating expenses before credit to incentive fee	55,595	53,465	2,130	4.0 %
Credit to incentive fee	—	(2,500)	2,500	(100.0)%
Total operating expenses	55,595	50,965	4,630	9.1 %
Other (expense) income				
Interest expense	(25,902)	(28,014)	2,112	(7.5)%
Distributions attributable to Series C mandatorily redeemable preferred stock	(1,502)	(2,743)	1,241	(45.2)%
Gain on sale of real estate	242	1,538	(1,296)	(84.3)%
Other income	343	14	329	2,350.0 %
Total other expense, net	(26,819)	(29,205)	2,386	(8.2)%
Net income	3,958	3,596	362	10.1 %
Distributions attributable to Series A, B and D preferred stock	(6,645)	(4,094)	(2,551)	62.3 %
Distributions attributable to senior common stock	(1,011)	(1,007)	(4)	0.4 %
Net loss attributable to common stockholders	$(3,698)	$(1,505)	$(2,193)	145.7 %
Net loss attributable to common stockholders per weighted average share of common stock - basic & diluted	$(0.16)	$(0.07)	$(0.09)	128.6 %
FFO available to common stockholders - basic	$35,593	$32,867	$2,726	8.3 %
FFO available to common stockholders - diluted	$36,604	$33,874	$2,730	8.1 %
Loss per weighted average share of common stock - basic & diluted	$(0.16)	$(0.07)	$(0.09)	128.6 %
FFO per weighted average share of common stock - basic	$1.53	$1.55	$(0.02)	