GLADSTONE COMMERCIAL

2004 ANNUAL REPORT

Gladstone Commercial Corporation is a real estate investment trust that invests in commercial and industrial real estate in North America. The focus of our company is to invest in triple net leased properties in which the tenant pays all costs regarding the property. We have significant ability to underwrite small and medium-sized business and do not need to have a third party rate the company. We operate in three segments. First, we seek to own the real estate that is rented by small and medium-sized businesses that do not have a corporate rating from a national rating agency. These are companies that are usually too small to be rated the way large businesses are rated. Second, we seek to own the real estate leased to companies controlled by buyout funds. We understand the area of leverage buyouts and know how they operate so we feel comfortable owning real estate leased to these small businesses. Third, we seek to invest in real estate that is owned by family-owned businesses in which the family seeks to sell the real estate and invest the proceeds in their business for growth. In summary, our tenants are unrated but we use our skill of underwriting to determine which non-rated tenants we believe will be good tenants.

We seek to invest in commercial and industrial real estate that will provide us a higher yielding opportunity than is achieved by investing in traditional real estate. All of our leases are what we describe as NNN leases, meaning that the tenant pays for all maintenance, taxes, and insurance on the land and buildings we lease to them. Our leases can be for 10 to 20 years and occasionally shorter leases are considered. We normally will finance the real estate with long-term mortgages so that we benefit from leverage.

Our headquarters are in McLean, VA, a suburb of Washington, DC and we have offices in Morristown, NJ, New York, NY, Chicago, IL and Pittsburgh, PA. We hope to open more offices in the future.

Dear Shareholders


(Pictured here from left to right are Terry Brubaker, David Gladstone and Chip Stelljes)

The year ending December 31, 2004 was a very interesting year. Interest rates for real estate mortgages are at all time lows but are moving up and are expected to continue to rise all through 2005. Real estate prices have been very high compared to past prices however, we know that cannot last because as interest rates rise, real estate prices should come down.

Commercial office buildings and industrial buildings that have a single tenant, where we like to invest, have attracted a significant amount of intuitional investors. Pension funds, insurance companies and other real estate investment trust are all seeking investments in this segment. Fortunately for us, most of them like to have tenants that have been rated by national rating agencies. And most of these investors have specialized in larger real estate transactions over $10 million per transaction. At the other end of the spectrum, small retail locations occupied by rated tenants have soared in price. These investments make little sense to anyone except the individual investor who is buying the real estate for tax purposes. Theses are called "1031 sales" and in recent years they have driven small retail real estate prices to all time highs. For example, a fast food location or a drug store location, that has a national tenant, is in very high demand. It would seem that most of this is being driven by the low yields investors are finding in bonds. Once long-term bond yields move back to the norm, the frenzy for real estate may subside.

In order to stay out of the way of the stampeding elephants (the pension funds) and swarms of grasshoppers (the retail buyer), we have concentrated on the small business and middle market tenants that are unrated. Since the tenant is unrated, most institutions are not interested. And since many of the real estate projects are small, most of the large buyers pass over them. This is good for us and gives us an opportunity to underwrite the tenant with the skills we honed in our other business of lending to small business. We are fortunate to have such a talented underwriting team.

We invested in 11 new real estate projects this year. Each of them has a special story. We think they are all good long-term investments that will pay rent which we in turn can pay out to shareholders as distributions. All of our investments are paying as agreed. We have no delinquencies as of this annual report and we don't expect any.

Beginning in January 2005 we began paying monthly dividends. As the year progresses we hope to increase the payout to shareholders.

Each time we invest our funds, it increases the payments to shareholders we can make in distributions. So the outlook for new investments is of high interest. We see the economy as strong and the need for commercial and industrial real estate increasing every month in 2005. We do not see any reason to believe that 2005 will be a down year for small and medium-sized business. It is with this as a backdrop that we believe that 2005 will be a good year for new real estate investments for us.

David Gladstone, Terry Brubaker
and Chip Stelljes

Strategy

OUR PLAN IS TO PAY MONTHLY DIVIDENDS TO OUR SHAREHOLDERS. WE SEEK TO INCREASE OUR TOTAL DIVIDEND PAYMENTS EACH YEAR. IN ORDER TO GENERATE THE INCOME NECESSARY TO MAKE OUR MONTHLY DIVIDEND PAYMENTS, WE OWN REAL ESTATE LEASED TO SMALL AND MEDIUM-SIZED BUSINESSES THAT WE BELIEVE HAVE TRADITIONALLY BEEN UNDERSERVED. WE EXPECT TO PURCHASE REAL ESTATE FROM BUSINESSES THAT NEED FUNDS TO FINANCE GROWTH, RESTRUCTURE THEIR BALANCE SHEETS OR EFFECT A CHANGE OF CONTROL, ALL OF WHICH WE BELIEVE ARE TYPICALLY UNDERSERVED BY TRADITIONAL INSTITUTIONS.

Our principal investment objectives are (1) to generate income for our shareholders in the form of monthly cash distributions that grow over time and (2) to increase the value of our common stock. Our primary strategy to achieve our investment objectives is to utilize the substantial knowledge and experience of our adviser's professionals in financing small and medium-sized businesses so that we own a diversified portfolio of leased commercial and industrial real estate and to occasionally make industrial and commercial mortgage loans that we believe will generate stable cash flow while the property increases in value.

To achieve our investment objectives, we intend to:

- acquire properties at favorable prices;
- lease industrial and commercial properties or selectively extend mortgage loans to creditworthy businesses;
- use borrowing to maximize the return to our shareholders while limiting the amount of our loss exposure on any property to the amount of equity invested in the property;
- increase the equity value in our real estate through regular mortgage principal payments;
- obtain equity interests in certain tenants or borrowers;
- participate in joint ventures that will permit us to own interests in large properties without restricting the diversity of our portfolio; and
- sell real estate assets from time to time at favorable prices.

Our Investments

OUR COMPANY BUYS EXISTING REAL ESTATE THAT IS USUALLY LEASED TO A SINGLE TENANT. THESE LEASES ARE USUALLY "NNN LEASES" OR "TRIPLE NET LEASES" MEANING THAT THE TENANT IS RESPONSIBLE FOR ALL MAINTENANCE, REPAIRS, INSURANCE AND TAXES ON THE PROPERTY. WE EXPECT THAT MOST OF OUR TENANTS WILL BE UNRATED BY A RATING AGENCY AND THAT WE WILL HAVE TO PERFORM AN UNDERWRITING ANALYSIS OF THE BUSINESS OF THE TENANT. OUR UNDERWRITING TEAM IS COMPOSED OF REAL ESTATE EXPERTS AND PROFESSIONALS WHO SPECIALIZE IN SMALL AND MEDIUM-SIZED BUSINESS LOANS. THESE BUSINESS EXPERTS ARE ALSO EMPLOYED BY OUR ADVISER TO MAKE UNDER-WRITING DECISIONS ON LOANS TO SMALL AND MEDIUM-SIZED BUSINESSES. BECAUSE OF THIS EXPERTISE, WE BELIEVE WE CAN SELECT GOOD UNRATED TENANTS FOR OUR REAL ESTATE. UNRATED TENANTS USUALLY PAY SIGNIFICANTLY MORE TO RENT BUILDINGS BUT HAVE RELATIVELY HIGHER RISK OF NOT MAKING THE RENTAL PAYMENTS. BECAUSE WE BELIEVE WE CAN UNDERWRITE AND THEN SELECT THE BEST UNRATED TENANTS, WE EXPECT TO HAVE A HIGHER RETURN ON THE EQUITY WE INVEST WHEN WE BUY A BUILDING AND RENT IT TO AN UNRATED TENANT.

We intend that substantially all of our investments will be income-producing leased real estate or mortgage loans. We expect that the majority of our investments will be real estate we own and the income will come from net leases, but if a net lease would have an adverse impact on a potential tenant, or would otherwise be inappropriate for us, we may structure our investment as a mortgage loan. We anticipate that acquired property will be either improved or, if under development, near completion. Investments will not be restricted as to geographical areas, but we expect that almost all of our investments in real estate will be made within the United States.

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, cash or through a combination of both. Units issued by our Operating Partnership will be redeemable for cash or, at our election, shares of our common stock on a one-for-one basis at any time after the first anniversary of the completion of this offering. However, we may in the future also conduct some of our business and hold some of our interests in real properties or mortgage loans through one or more wholly owned subsidiaries, each classified as a "qualified REIT subsidiary."

Selection of Opportunities

WE WILL CONDUCT SUBSTANTIALLY ALL OF OUR ACTIVITIES THROUGH, AND SUBSTANTIALLY ALL OF OUR PROPERTIES WILL BE HELD DIRECTLY OR INDIRECTLY BY, GLADSTONE COMMERCIAL LIMITED PARTNERSHIP THAT WE REFER TO HEREIN AS OUR "OPERATING PARTNERSHIP." FOR THOSE WHO WISH TO SELL THEIR REAL ESTATE IN A TAX-FREE EXCHANGE, WE WILL EXCHANGE LIMITED PARTNERSHIP UNITS FOR THEIR REAL ESTATE. THE LIMITED PARTNERSHIP UNITS ARE CONVERTIBLE INTO COMMON STOCK OF OUR COMPANY.

Businesses that are owned by buyout funds and many family-owned businesses often have substantial amounts of equity in their real estate. A primary reason for this is that real estate lenders have been making real estate loans at relatively low amounts when compared to the value of the real estate securing the loans. Since banks are only lending a low percentage of the value of the property, this means the owner of the real estate has a substantial amount of equity in the real estate. One method for these businesses to free up the equity in their real estate is by selling their real estate to us and simultaneously leasing it back from us under a long-term, triple net lease. Sellers in these "sale-leaseback" transactions can then use the freed up cash to repay existing indebtedness or for growth capital, thus strengthening their balance sheets and permitting them to lower their overall costs of capital for growth and expansion.

We believe that there are many businesses in the United States that have a substantial amount of equity tied up in their real estate. Because of the experience of our officers and professionals investing in real estate-related assets and managing funds that lend to similar businesses, we believe our management team is uniquely positioned to identify and evaluate these sale-leaseback opportunities and to negotiate attractive investments. We also believe there are a substantial number of businesses that would not be interested in a sale-leaseback transaction, but would benefit from refinancing their current real estate mortgage loans. To address this need, we also selectively offer long-term mortgage loans on competitive terms and conditions.

Corporate Information

Directors, Officers and Team Members

David Gladstone
Chief Executive Officer and Chairman of the Board

Terry Brubaker
President, Chief Operating Officer and Director

Chip Stelljes, III
Chief Investment Officer

Harry Brill
Chief Financial Officer

Paul Adelgren
Director and Pastor of Missionary Church

Maurice Coulon
Director and Private Real Estate Investor

David A.R. Dullum
Director and Partner of New England Partners

Michela English
Director and Private Investor

Anthony W. Parker
Director and Chairman of Medical Funding Corp.

John Outland
Director and Vice President of Genworth Financial

Joseph Bute, *Managing Director,* Pennsylvania

Buzz Cooper, *Managing Director,* Virginia

Robert Corry, *Managing Director,* New Jersey

John Freal, *Managing Director,* Virginia

Laura Gladstone, *Managing Director,* New York

Chris Massey, *Managing Director,* Virginia

Bob Pierce, *Managing Director,* Chicago

Virginia Rollins, *Principal,* Virginia

Greg Bowie, *Associate*

Bryan Carter, *Associate*

Jonathan Chou, *Associate*

Pamela Keene, *Director of Portfolio Records*

Donya Kolcio, *Controller*

Brian McCahill, *Portfolio Manager*

Paula Novara, *Head of Resources Management and Chief Compliance Officer*

Danielle Siedman, *Senior Accountant*

Stock Exchange Listing

The common stock of the company trades on The Nasdaq National Stock Market under the symbol GOOD.

Auditors and Tax Consultants

PricewaterhouseCoopers LLP

Legal Counsel

Cooley Godward, LLP

Transfer Agent

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Shareholder Relations
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Outside the US:
1 610 382 7833
(collect calls accepted)

Dividend Reinvestment Plan

The company offers a dividend reinvestment plan to its shareholders. Shareholders whose shares are held in their names should contact the transfer agent to enroll. Shareholders whose shares are held by a brokerage firm should contact their broker to enroll.

Financial Information

Shareholders may receive a copy of SEC Forms 10-K and 10-Q by visiting the company website at www.GladstoneCommercial.com or going to the SEC website at www.SEC.gov or by visiting the SEC at 450 5th Street, N.W., Washington, DC 20549.

Company Website

www.GladstoneCommercial.com

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Picture on the cover is of the Lincoln Memorial.

GLADSTONE COMMERCIAL

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