# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**WASHINGTON, D.C. 20549**

# FORM 10-Q

(Mark One)

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

**For the quarterly period ended March 31, 2012**

**or**

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

**Commission File Number 000-52566**

# CORNERSTONE CORE PROPERTIES REIT, INC.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **MARYLAND**<br>**(State or other jurisdiction of incorporation or organization)** | **73-1721791**<br>**(I.R.S. Employer Identification No.)** |
| **1920 MAIN STREET, SUITE 400, IRVINE, CA**<br>**(Address of principal executive offices)** | **92614**<br>**(Zip Code)** |

**949-852-1007**
**(Registrant's telephone number, including area code)**

**Not Applicable**
**(Former name, former address and former fiscal year, if changed since last report)**

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

Indicate by check mark whether the registrant 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 (Sec.232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer ☐ | Accelerated filer ☐ |
| Non-accelerated filer ☐ (Do not check if a smaller reporting company) | Smaller reporting company ☒ |

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

As of May 15, 2012, we had 23,028,285 shares issued and outstanding.

**PART I — FINANCIAL INFORMATION**
**FORM 10-Q**
**Cornerstone Core Properties REIT, Inc.**
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**CORNERSTONE CORE PROPERTIES REIT, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)**

| | March 31, 2012 | December 31, 2011 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | $ 8,936,000 | $ 17,388,000 |
| Investments in real estate: | | |
| Land | 11,733,000 | 11,733,000 |
| Buildings and improvements, net | 33,011,000 | 33,330,000 |
| Intangible lease assets, net | 70,000 | 83,000 |
| Net real estate | 44,814,000 | 45,146,000 |
| Notes receivable, net | 908,000 | 908,000 |
| Note receivable from related party (Note 8) | — | — |
| Deferred costs and deposits | 23,000 | 27,000 |
| Deferred financing costs, net | 74,000 | 91,000 |
| Tenant and other receivables, net | 479,000 | 567,000 |
| Other assets, net | 572,000 | 625,000 |
| Assets of variable interest entity held for sale | 4,263,000 | 5,372,000 |
| Total assets | $ 60,069,000 | $ 70,124,000 |
| **LIABILITIES AND EQUITY** | | |
| Notes payable | $ 13,397,000 | $ 21,070,000 |
| Accounts payable and accrued liabilities | 916,000 | 785,000 |
| Payable to related parties | 94,000 | 20,000 |
| Prepaid rent, security deposits and deferred revenue | 412,000 | 460,000 |
| Intangible lease liabilities, net | 34,000 | 44,000 |
| Liabilities of variable interest entity held for sale | 2,273,000 | 2,119,000 |
| Total liabilities | 17,126,000 | 24,498,000 |
| Commitments and contingencies (Note 14) | | |
| Preferred stock, $0.001 par value; 10,000,000 shares authorized; no shares issued or outstanding at March 31, 2012 and December 31, 2011 | — | — |
| Common stock, $0.001 par value; 290,000,000 shares authorized; 23,028,285 shares issued and outstanding at March 31, 2012 and December 31, 2011, respectively | 23,000 | 23,000 |
| Additional paid-in capital | 116,238,000 | 116,238,000 |
| Accumulated deficit | (71,128,000) | (68,748,000) |
| Total stockholders' equity | 45,133,000 | 47,513,000 |
| Noncontrolling interests | (2,190,000) | (1,887,000) |
| Total equity | 42,943,000 | 45,626,000 |
| Total liabilities and equity | $ 60,069,000 | $ 70,124,000 |

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

**CORNERSTONE CORE PROPERTIES REIT, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

| | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---|---|---|
| Revenues: | | |
| Rental revenues | $ 798,000 | $ 875,000 |
| Tenant reimbursements and other income | 206,000 | 230,000 |
| Interest income from notes receivable | 13,000 | 159,000 |
| | 1,017,000 | 1,264,000 |
| Expenses: | | |
| Property operating and maintenance | 354,000 | 393,000 |
| General and administrative | 1,034,000 | 615,000 |
| Asset management fees and expenses | 215,000 | 415,000 |
| Depreciation and amortization | 381,000 | 530,000 |
| | 1,984,000 | 1,953,000 |
| Operating loss | (967,000) | (689,000) |
| Interest expense | (266,000) | (291,000) |
| Loss from continuing operations | (1,233,000) | (980,000) |
| Discontinued operations: | | |
| (Loss) income before impairments | (310,000) | 208,000 |
| Impairment of real estate asset held for sale | (1,140,000) | — |
| (Loss) income from discontinued operations | (1,450,000) | 208,000 |
| Net loss | (2,683,000) | (772,000) |
| Noncontrolling interests' share in losses | 303,000 | — |
| Net loss applicable to common shares | $ (2,380,000) | $ (772,000) |
| Basic and diluted (losses) earnings per common share: | | |
| Continuing operations | $ (0.05) | $ (0.04) |
| Discontinued operations | (0.05) | 0.01 |
| Net loss applicable to common shares | $ (0.10) | $ (0.03) |
| Weighted average shares used to calculate basic and diluted (losses) earnings per common share | 23,028,284 | 23,039,808 |
| Distributions declared per common share | $ — | $ 0.02 |

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

**CORNERSTONE CORE PROPERTIES REIT, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF EQUITY**
**For the Three Months Ended March 31, 2012 and 2011**
**(Unaudited)**

| | Common Stock | | | | | | |
|---|---|---|---|---|---|---|---|
| | Number of Shares | Common Stock Par Value | Additional Paid-In Capital | Accumulated Deficit | Total Stockholders' Equity | Noncontrolling Interests | Total Equity |
| **Balance — December 31, 2011** | **23,028,285** | **$23,000** | **$116,238,000** | **$(68,748,000)** | **$ 47,513,000** | **$(1,887,000)** | **$ 45,626,000** |
| Issuance of common stock | — | — | — | — | — | — | — |
| Redeemed shares | — | — | — | — | — | — | — |
| Dividends declared | — | — | — | — | — | — | — |
| Net loss | — | — | — | (2,380,000) | (2,380,000) | (303,000) | (2,683,000) |
| **Balance — March 31, 2012** | **23,028,285** | **$23,000** | **$116,238,000** | **$(71,128,000)** | **$ 45,133,000** | **$(2,190,000)** | **$ 42,943,000** |

| | Common Stock | | | | | | |
|---|---|---|---|---|---|---|---|
| | Number of Shares | Common Stock Par Value | Additional Paid-In Capital | Accumulated Deficit | Total Stockholders' Equity | Noncontrolling Interests | Total Equity |
| **Balance — December 31, 2010** | **23,074,381** | **$23,000** | **$117,520,000** | **$(16,690,000)** | **$100,853,000** | **$ 117,000** | **$100,970,000** |
| Issuance of common stock | — | — | — | — | — | — | — |
| Redeemed shares | (47,146) | — | (369,000) | — | (369,000) | — | (369,000) |
| Dividends declared | — | — | (454,000) | — | (454,000) | (3,000) | (457,000) |
| Net loss | — | — | — | (772,000) | (772,000) | — | (772,000) |
| **Balance — March 31, 2011** | **23,027,235** | **$23,000** | **$116,697,000** | **$(17,462,000)** | **$ 99,258,000** | **$ 114,000** | **$ 99,372,000** |

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

**CORNERSTONE CORE PROPERTIES REIT, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(Unaudited)**

| | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net loss | $ (2,683,000) | $ (772,000) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Amortization of deferred financing costs | 61,000 | 84,000 |
| Depreciation and amortization | 381,000 | 833,000 |
| Straight-line rents and amortization of acquired above-market lease intangibles, net | 4,000 | 36,000 |
| Impairment of real estate | 1,140,000 | — |
| Provision for bad debt | (6,000) | (15,000) |
| Change in operating assets and liabilities: | | |
| Tenant and other receivables | 63,000 | 103,000 |
| Other assets | (32,000) | (9,000) |
| Accounts payable and accrued liabilities | 287,000 | 385,000 |
| Payable to related parties, net | 74,000 | — |
| Prepaid rent, security deposits and deferred revenue | (89,000) | (164,000) |
| **Net cash (used in) provided by operating activities** | (800,000) | 481,000 |
| **Cash flows from investing activities:** | | |
| Real estate improvements | (24,000) | (168,000) |
| **Net cash used in investing activities** | (24,000) | (168,000) |
| **Cash flows from financing activities:** | | |
| Redeemed shares | — | (369,000) |
| Security deposit refunded/received, net | 43,000 | — |
| Repayment of notes payable | (7,673,000) | (434,000) |
| Offering costs | — | (40,000) |
| Distributions paid to stockholders | — | (454,000) |
| Distributions paid to noncontrolling interests | — | (3,000) |
| Deferred financing costs | (44,000) | (17,000) |
| **Net cash used in financing activities** | (7,674,000) | (1,317,000) |
| Net decrease in cash and cash equivalents | (8,498,000) | (1,004,000) |
| Cash and cash equivalents — beginning of period | 17,483,000 | 2,014,000 |
| Cash and cash equivalents — end of period (including cash of VIE) | $ 8,985,000 | $ 1,010,000 |
| Cash and cash equivalents of VIE — end of period (see Note 15) | 49,000 | — |
| Cash and cash equivalents — end of period | $ 8,936,000 | $ 1,010,000 |
| **Supplemental disclosure of cash flow information:** | | |
| Cash paid for interest | $ 266,000 | $ 210,000 |
| **Supplemental disclosure of non-cash financing and investing activities:** | | |
| Accrual for distribution declared | $ — | $ 156,000 |
| Accrued leasing commissions | $ 2,000 | $ — |
| Accrued real estate improvements | $ — | $ 291,000 |

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

**CORNERSTONE CORE PROPERTIES REIT, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**MARCH 31, 2012**
**(Unaudited)**

## 1. Organization

Cornerstone Core Properties REIT, Inc., a Maryland Corporation, was formed on October 22, 2004 under the General Corporation Law of Maryland for the purpose of engaging in the business of investing in and owning commercial real estate. As used in this report, the "Company", "we", "us" and "our" refer to Cornerstone Core Properties REIT, Inc. and its consolidated subsidiaries except where the context otherwise requires. Subject to certain restrictions and limitations, our business is managed pursuant to an advisory agreement (the "Advisory Agreement") by an affiliate, Cornerstone Realty Advisors, LLC (the "Advisor"), a Delaware limited liability company that was formed on November 30, 2004.

Cornerstone Operating Partnership, L.P. (the "Operating Partnership"), a Delaware limited partnership, was formed on November 30, 2004. At March 31, 2012, we owned a 99.88% general partner interest in the Operating Partnership while the Advisor owned a 0.12% limited partnership interest. We anticipate that we will conduct all or a portion of our operations through the Operating Partnership. Our financial statements and the financial statements of the Operating Partnership are consolidated in the accompanying condensed consolidated financial statements. These financial statements include consolidation of a variable interest entity (see Note 9). All intercompany accounts and transactions have been eliminated in consolidation.

## 2. Public Offerings

On January 6, 2006, we commenced a public offering of a minimum of 125,000 shares and a maximum of 55,400,000 shares of our common stock, consisting of 44,400,000 shares for sale to the public (the "Primary Offering") and 11,000,000 shares for sale pursuant to our distribution reinvestment plan. We stopped making offers under our initial public offering on June 1, 2009 upon raising gross offering proceeds of approximately $172.7 million from the sale of approximately 21.7 million shares, including shares sold under the distribution reinvestment plan. On June 10, 2009, the U.S. Securities Exchange Commission (the "SEC") declared our follow-on offering effective and we commenced a follow-on offering of up to 77,350,000 shares of our common stock, consisting of 56,250,000 shares for sale to the public (the "Follow-On Offering") and 21,100,000 shares for sale pursuant to our dividend reinvestment plan. The Primary Offering and Follow-On Offering are collectively referred to as the "Offerings." We retained Pacific Cornerstone Capital, Inc. ("PCC"), an affiliate of our Advisor, to serve as the dealer manager for the Offerings. PCC is responsible for marketing our shares being offered pursuant to the Offerings.

On November 23, 2010, we informed our investors of several decisions made by the board of directors for the health of our REIT.

**The Offering**. Effective November 23, 2010, we stopped making and accepting offers to purchase shares of our stock while our board of directors evaluates strategic alternatives to maximize value.

**Suspension of Distribution Reinvestment Plan**. Our Offerings included a distribution reinvestment plan under which our stockholders could elect to have all or a portion of their distributions reinvested in additional shares of our common stock. Consistent with the above decision with respect to the Offerings, we suspended our distribution reinvestment plan effective on December 14, 2010. All distributions paid after December 14, 2010 have been and will be made in cash.

**Distributions**. Effective December 1, 2010, our board of directors resolved to reduce distributions on our common stock to an annualized rate of $0.08 per share (1% based on a share price of $8.00), from the prior annualized rate of $0.48 per share (6% based on a share price of $8.00), in order to preserve capital that may be needed for capital improvements, debt repayment or other corporate purposes. Distributions at this rate were declared for the first and second quarters of 2011. In June 2011, the board decided, based on the financial position of the Company, to suspend the declaration of further distributions and to defer the payment of the second quarter 2011 distribution, which was paid in December 2011. No distributions have been declared for periods after June 30, 2011. The rate and frequency of distributions is subject to the discretion of our board of directors and may change from time to time based on our operating results and cash flow.

**Stock Repurchase Program**. After careful consideration of the proceeds that were available from our distribution reinvestment plan in 2010, and an assessment of our expected capital expenditures, tenant improvement costs and other costs and obligations related to our investments, our board of directors concluded that we did not have sufficient funds available to us to prudently fund any redemptions during 2011. Accordingly, our board of directors approved an amendment to our stock repurchase program to suspend redemptions under the program, effective December 31, 2010. We can make no assurances as to when and on what terms redemptions will resume. The share redemption program may be amended, resumed, suspended again, or terminated at any time based in part on our cash and debt position.

We used the net proceeds from our Primary Offering to invest primarily in multi-tenant industrial real estate located in major metropolitan markets in the United States. If we resume our Follow-On Offering, we intend to use the net proceeds from our Follow-On Offering to acquire additional real estate investments and pay down temporary acquisition financing on our existing assets.

As of March 31, 2012, we had raised $167.1 million of gross proceeds from the sale of 20.9 million shares of our common stock in our Primary Offering and Follow-On Offering and had acquired thirteen properties, four of which were sold during 2011. Our revenues, which are comprised largely of rental income, include rents reported on a straight-line basis over the initial term of the lease. Our growth depends, in part, on our ability to increase rental income and other earned income from leases by increasing rental rates and occupancy levels and control operating and other expenses. Our operations are impacted by property-specific, market-specific, general economic and other conditions.

Our board of directors continues to evaluate and implement strategic alternatives to reposition the company and preserve and increase shareholders' value. Specifically, we sold the Goldenwest property in June 2011 for gross proceeds of $9.4 million and made a principal payment of $7.8 million on the HSH Nordbank credit facility. Additionally, we sold the Mack Deer Valley and Pinnacle Park Business Center properties in November 2011 for gross proceeds of approximately $23.9 million. The proceeds were used, in part, to pay down the remaining balance of the HSH Nordbank credit facility. In December 2011, we sold the 2111 South Industrial Park property for gross proceeds of $0.9 million. The proceeds were used to pay down the Wells Fargo Bank, National Association loan. Furthermore, in February 2012, we amended our loan agreement with Wells Fargo Bank, National Association. The amendment, executed upon our making a $7.5 million principal payment, extended the maturity date of the loan from February 13, 2012 to February 13, 2014 and reduced the interest rate from 300 basis points over one-month LIBOR to 200 basis points over one-month LIBOR, with the LIBOR floor remaining fixed at 150 basis points. We are continuing to pursue options for repaying our debt, including asset sales.

### 3. Summary of Significant Accounting Policies

The preparation of our condensed consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. We base these estimates on various assumptions that we believe to be reasonable under the circumstances, and these estimates form the basis for our judgments concerning the carrying values of assets and liabilities that are not readily apparent from other sources. We periodically evaluate these estimates and judgments based on available information and experience. Actual results could differ from our estimates under different assumptions and conditions. If actual results significantly differ from our estimates, our financial condition and results of operations could be materially impacted. For more information regarding our critical accounting policies and estimates please refer to "Summary of Significant Accounting Policies" contained in our Annual Report on Form 10-K for the year ended December 31, 2011. There have been no material changes to the critical accounting policies previously disclosed in that report except as discussed below.

#### *Interim Financial Information*

The accompanying interim condensed consolidated financial statements have been prepared by our management in accordance with accounting principles generally accepted in the United States of America ("GAAP") and in conjunction with the rules and regulations of the SEC. Certain information and footnote disclosures required for annual financial statements have been condensed or excluded pursuant to SEC rules and regulations. Accordingly, the interim condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. The accompanying financial information reflects all adjustments which are, in the opinion of management, of a normal recurring nature and necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods. Interim results of operations are not necessarily indicative of the results to be expected for the full year. The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the 2011 Annual Report on Form 10-K as filed with the SEC. Operating results for the three months ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

***Fair Value of Financial Instruments and Fair Value Measurements***

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 825-10, *Financial Instruments*, requires the disclosure of fair value information about financial instruments whether or not recognized on the face of the balance sheet, for which it is practical to estimate that value.

Fair value represents the estimate of the proceeds to be received, or paid in the case of a liability, in a current transaction between willing parties. ASC 820, *Fair Value Measurement ("ASC 820")* establishes a fair value hierarchy to categorize the inputs used in valuation techniques to measure fair value. Inputs are either observable or unobservable in the marketplace. Observable inputs are based on market data from independent sources and unobservable inputs reflect the reporting entity's assumptions about market participant assumptions used to value an asset or liability.

Financial assets and liabilities recorded at fair value on the condensed consolidated balance sheets are categorized based on the inputs to the valuation techniques as follows:

*Level 1.* Quoted prices in active markets for identical instruments.

*Level 2.* Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

*Level 3.* Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities measured at fair value are classified according to the lowest level input that is significant to their valuation. A financial instrument that has a significant unobservable input along with significant observable inputs may still be classified as a Level 3 instrument.

We generally determine or calculate the fair value of financial instruments using quoted market prices in active markets when such information is available or appropriate present value or other valuation techniques, such as discounted cash flow analyses, incorporating available market discount rate information for similar types of instruments and our estimates for non-performance and liquidity risk. These techniques are significantly affected by the assumptions used, including the discount rate, credit spreads, and estimates of future cash flow.

Our condensed consolidated balance sheets include the following financial instruments: cash and cash equivalents, notes receivable, tenant and other receivables, certain other assets, deferred costs and deposits, accounts payable and accrued liabilities, payable to related parties, prepaid rent, security deposits and deferred revenue, and notes payable. With the exception of notes receivable and notes payable discussed below, we consider the carrying values to approximate fair value for such financial instruments based on Level 1 inputs because of the short period of time between origination of the instruments and their expected payment.

As of March 31, 2012 and December 31, 2011, the fair value of notes receivable was approximately \$0.9 million and \$0.9 million, compared to the carrying value of approximately \$0.9 million and \$0.9 million, respectively. The fair value of notes receivable is estimated by discounting the expected cash flows at current market rates at which management believes similar loans would be made. To estimate fair value at March 31, 2012, we discounted the expected cash flows using a rate of 10.00%. As the inputs to our valuation estimate are neither observable in nor supported by market activity, our notes receivable are classified as Level 3 assets within the fair value hierarchy.

As of March 31, 2012 and December 31, 2011, the fair value of notes payable was approximately $13.8 million and $21.3 million, compared to the carrying value of approximately $13.4 million and $21.1 million, respectively. The fair value of notes payable is estimated by discounting the contractual cash payments using lending rates available to us for financial instruments with similar terms and maturities. To estimate fair value at March 31, 2012, we utilized discount rates ranging from 3.50% to 3.93%. As the inputs to our valuation estimate are neither observable in nor supported by market activity, our notes payable are classified as Level 3 assets within the fair value hierarchy.

As a result of our ongoing analysis for potential impairment of our investments in real estate, including properties classified as held for sale, we were required to adjust the carrying value of certain assets to their estimated fair values as of March 31, 2012 (see Note 4).

The following table summarizes the assets measured at fair value on a nonrecurring basis during the first quarter of 2012:

| | Total Fair Value Measurement | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Net Losses for the Quarter Ended March 31, 2012 |
|---|---|---|---|---|---|
| Variable interest entity held for sale | $3,760,000 | $ — | $3,760,000 | $ — | $(1,140,000) |

The variable interest entity held for sale measured at fair value during the first quarter of 2012 is deemed to be a Level 2 asset as we have received a formal offer for the property. We do not believe that this asset is a Level 1 asset as a purchase and sale agreement has not been signed and the potential buyer may opt out of the transaction at its discretion.

At March 31, 2012 and December 31, 2011, we do not have any significant financial assets or financial liabilities that are measured at fair value on a recurring basis in our condensed consolidated financial statements.

***Variable Interest Entities***

The Company analyzes its contractual and/or other interests to determine whether such interests constitute an interest in a variable interest entity ("VIE") in accordance with ASC 810, *Consolidation* ("ASC 810"), and, if so, whether the Company is the primary beneficiary. If the Company is determined to be the primary beneficiary of a VIE, it must consolidate the VIE. A VIE is an entity with insufficient equity investment or in which the equity investors lack some of the characteristics of a controlling financial interest. In determining whether it is the primary beneficiary, the Company considers, among other things, whether it has the power to direct the activities of the VIE that most significantly impact the entity's economic performance, including, but not limited to, determining or limiting the scope or purpose of the VIE, selling or transferring property owned or controlled by the VIE, or arranging financing for the VIE. The Company also considers whether it has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE (see Note 9).

***Reclassification***

Assets sold or held for sale and associated liabilities have been reclassified on the condensed consolidated balance sheets and operating results have been reclassified from continuing to discontinued operations.

***Recently Issued Accounting Pronouncements***

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ("ASU 2011-04"). The amendments in this update result in additional fair value measurement and disclosure requirements within U.S. GAAP and IFRS. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The Company's adoption of ASU 2011-04 on January 1, 2012 did not have a significant impact on its consolidated financial condition, results of operations, and/or its disclosures.

## 4. Investments in Real Estate

As of March 31, 2012, our portfolio consists of nine properties which were approximately 71.4% leased. The following table provides summary information regarding our properties.

| Property[1] | Location | Date Purchased | Square Footage | Purchase Price | Debt | March 31, 2012 % Leased |
|---|---|---|---|---|---|---|
| Shoemaker Industrial Buildings | Santa Fe Springs, CA | June 30, 2006 | 18,921 | $ 2,400,000 | $ — | 75.7% |
| 20100 Western Avenue | Torrance, CA | December 1, 2006 | 116,433 | 19,650,000 | — | 51.5% |
| Marathon Center | Tampa Bay, FL | April 2, 2007 | 52,020 | 4,450,000 | — | 26.1% |
| Orlando Small Bay Portfolio: | | | | | | |
| Carter Commerce Center | Winter Garden, FL | November 15, 2007 | 49,125 | | | 53.4% |
| Goldenrod Commerce Center | Orlando, FL | November 15, 2007 | 78,646 | | | 85.8% |
| Hanging Moss Commerce Center | Orlando, FL | November 15, 2007 | 94,200 | | | 80.4% |
| Monroe South Commerce Center | Sanford, FL | November 15, 2007 | 172,500 | | | 62.6% |
| | | | 394,471 | 37,128,000 | 6,769,000 | 70.3% |
| Monroe North Commerce Center | Sanford, FL | April 17, 2008 | 181,348 | 14,275,000 | 6,628,000 | 97.3% |
| 1830 Santa Fe | Santa Ana, CA | August 5, 2010 | 12,200 | 1,315,000 | — | 100.0% |
| | | | 775,393 | $79,218,000 | $13,397,000 | 71.4% |

(1) The table excludes Sherburne Commons, a variable interest entity for which we became the primary beneficiary and began consolidating their financial results as of June 30, 2011. As of October 19, 2011, Sherburne Commons was classified as held for sale (see Notes 8 and 9).

As of March 31, 2012, adjusted cost and accumulated depreciation and amortization related to investments in real estate and related intangible lease assets and liabilities were as follows:

| | Land | Buildings and Improvements | Acquired Above-Market Leases | In-Place Lease Value | Acquired Below-Market Leases |
|---|---|---|---|---|---|
| Investments in real estate and related intangible lease assets (liabilities) | $11,733,000 | $34,204,000 | $ 1,401,000 | $ 1,181,000 | $(620,000) |
| Less: accumulated depreciation and amortization | — | (1,193,000) | (1,369,000) | (1,143,000) | 586,000 |
| Net investments in real estate and related intangible lease assets (liabilities) | $11,733,000 | $33,011,000 | $ 32,000 | $ 38,000 | $ (34,000) |

As of December 31, 2011, adjusted cost and accumulated depreciation and amortization related to investments in real estate and related intangible lease assets and liabilities were as follows:

| | Land | Buildings and Improvements | Acquired Above-Market Leases | In-Place Lease Value | Acquired Below-Market Leases |
|---|---|---|---|---|---|
| Investments in real estate and related intangible lease assets (liabilities) | $11,733,000 | $34,180,000 | $ 1,401,000 | $ 1,181,000 | $(620,000) |
| Less: accumulated depreciation and amortization | — | (850,000) | (1,365,000) | (1,134,000) | 576,000 |
| Net investments in real estate and related intangible lease assets (liabilities) | $11,733,000 | $33,330,000 | $ 36,000 | $ 47,000 | $ (44,000) |

Depreciation expense associated with buildings and improvements, including real estate held for sale, for the three months ended March 31, 2012 and 2011 was $0.3 million and $0.7 million, respectively. We are required to make subjective assessments as to the useful lives of our depreciable assets. In making such assessments, we consider each asset's expected period of future economic benefit to estimate the appropriate useful lives.

Net amortization expense associated with the intangible lease assets and liabilities, including those associated with real estate held for sale, for the three months ended March 31, 2012 and 2011 was $3,000, and $57,000, respectively. Estimated net amortization expense for April 1, 2012 through December 31, 2012 and for each of the five following years ended December 31 is as follows:

| | Amortization of Intangible Lease Assets |
|---|---|
| April 1, 2012 to December 31, 2012 | $ 3,000 |
| 2013 | $ 19,000 |
| 2014 | $ 8,000 |
| 2015 | $ 6,000 |
| 2016 | $ — |
| 2017 and thereafter | $ — |

The estimated useful lives of intangible lease assets range from approximately one month to four years. As of March 31, 2012, the weighted-average amortization period for in-place leases, acquired above-market leases and acquired below-market leases were 1.6 years, 2.4 years and 0.8 years, respectively.

***Impairments***

In accordance with ASC 360, *Property, Plant, and Equipment* ("ASC 360"), we conduct a comprehensive review of our real estate assets for impairment. ASC 360 requires that asset values be analyzed whenever events or changes in circumstances indicate that the carrying value of a property may not be fully recoverable.

Indicators of potential impairment include the following:

- Change in strategy resulting in a decreased holding period;
- Decreased occupancy levels;
- Deterioration of the rental market as evidenced by rent decreases over numerous quarters;
- Properties adjacent to or located in the same submarket as those with recent impairment issues;
- Significant decrease in market price; and/or
- Tenant financial problems.

The intended use of an asset, either held for sale or held and used, can significantly impact how impairment is measured. If an asset is intended to be held and used, the impairment analysis is based on a two-step test.

The first test measures estimated expected future cash flows over the holding period, including a residual value (undiscounted and without interest charges), against the carrying value of the property. If the asset fails that test, the asset carrying value is compared to the estimated fair value from a market-participant standpoint, with the excess of the asset's carrying value over the estimated fair value recognized as an impairment charge to earnings.

We recorded no impairment charges related to properties held and used for the three months ended March 31, 2012 and 2011.

***Real Estate Held for Sale***

In the fourth quarter of 2011, we reclassified Nantucket Acquisition LLC, a VIE for which we are the primary beneficiary, to real estate held for sale. The financial results for the properties classified as real estate held for sale have been reclassified to discontinued operations for all periods presented (see Note 15).

When assets are classified as held for sale, they are recorded at the lower of carrying value or the estimated fair value of the asset, net of estimated selling costs. Accordingly, we assessed Sherburne Commons, the property owned by Nantucket Acquisition LLC, to determine whether its carrying value exceeded its estimated fair value, net of estimated selling costs as of March 31, 2012. We estimated fair value, net of estimated selling costs for Sherburne Commons based on a formal offer received from an independent third party to acquire the property. Consequently, we recorded an impairment charge of $1.1 million in the first quarter of 2012. The property is deemed to be a Level 2 asset as our estimate of fair value is based on a non-binding purchase offer. We do not believe that this asset is a Level 1 asset as a purchase and sale agreement has not been signed and the potential buyer may opt out of the transaction at its discretion.

The following table summarizes the assets measured at fair value on a nonrecurring basis as of the quarter ended March 31, 2012:

| | Total Fair Value Measurement | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Net Losses for the Quarter Ended March 31, 2012 |
|---|---|---|---|---|---|
| Variable interest entity held for sale | $3,760,000 | $ — | $3,760,000 | $ — | $(1,140,000) |

***Leasing Commissions***

Leasing commissions are capitalized at cost and amortized on a straight-line basis over the related lease term. As of March 31, 2012 and December 31, 2011, we recorded approximately $0.5 million and $0.4 million in leasing commissions, respectively. Amortization expense for the three months ended March 31, 2012 and 2011 was approximately $30,000 and $32,000, respectively.

**5. Allowance for Doubtful Accounts**

Our allowance for doubtful accounts was $0.2 million as of March 31, 2012 and December 31, 2011.

**6. Concentration of Risk**

Financial instruments that potentially subject us to a concentration of credit risk are primarily cash investments, notes receivable and the note receivable from related party. Refer to Notes 7 and 8 with regard to credit risk evaluation of notes receivable and the note receivable from related party. Cash is generally invested in investment-grade short-term instruments. On July 21, 2010, President Obama signed into law the “Dodd-Frank Wall Street Reform and Consumer Protection Act” that implements significant changes to the regulation of the financial services industry, including provisions that made permanent the $250,000 limit for federal deposit insurance and increased the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000, and provided unlimited federal deposit insurance until January 1, 2013, for non-interest bearing demand transaction accounts at all insured depository institutions. As of March 31, 2012, we had cash accounts in excess of FDIC-insured limits. We believe this risk is not significant.

As of March 31, 2012, we owned three properties in the state of California and six properties in the state of Florida. Accordingly, there is a geographic concentration of risk subject to fluctuations in each state’s economy.

**7. Notes Receivable**

In May 2008, we agreed to loan up to $10.0 million at a rate of 10% per year to two real estate operating companies, Servant Investments, LLC (“SI”) and Servant Healthcare Investments, LLC (“SHI” and collectively with SI, “Servant”). In May 2010, the loan commitments were reduced to $8.75 million. The loans were scheduled to mature on May 19, 2013. At the time the loans were negotiated, Servant was a sub-advisor in an alliance with the managing member of our Advisor.

On a quarterly basis, we evaluate the collectability of our notes receivable. Our evaluation of collectability involves judgment, estimates, and a review of the underlying collateral and borrower’s business models and future cash flows from operations. During the third quarter of 2009, we concluded that the collectability of the SI note could not be reasonably assured. Therefore, we recorded a reserve of $4.6 million against the note balance. As of December 31, 2011 and 2010, the SI note receivable had a net balance of $0. It is our policy to recognize interest income on the reserved loan on a cash basis. For the years ended December 31, 2011, 2010, and 2009, interest income related to the SI note receivable was $0, $0.4 million, and $0.3 million, respectively.

In the second quarter of 2011, after evaluating the expected effects of changes in the borrower's business prospects, including the uncertainty surrounding Servant's realization of the fees pursuant to a sub-advisory agreement, we concluded that it was probable that the Company would be unable to collect all amounts due according to the terms of the SHI note and consequently, we recorded a note receivable impairment of $1.7 million against the balance of that note.

In December 2011, the notes receivable were restructured to provide for the settlement of the notes in the amount of $2.5 million, $1.5 million of which was received from the borrower in December 2011. The remaining $1.0 million is payable pursuant to a promissory note of SHI which provides for interest at a fixed rate of 5.00% per annum. A principal payment of $0.7 million, plus any accrued and unpaid interest, is due on December 22, 2013 and the remaining balance of $0.3 million, plus any accrued and unpaid interest, is due on December 22, 2014. The note receivable was recorded at its present value of $0.9 million on our consolidated balance sheet as of December 31, 2011.

The following table reconciles notes receivable from January 1, 2012 to March 31, 2012 and from January 1, 2011 to March 31, 2011:

| | 2012 | 2011 |
|---|---|---|
| Balance at January 1, | $908,000 | $4,000,000 |
| Additions: | | |
| Additions to notes receivable | — | — |
| Deductions: | | |
| Notes receivable repayments | — | — |
| Notes receivable impairments | — | — |
| Balance at March 31, | $908,000 | $4,000,000 |

As of March 31, 2012 and December 31, 2011, the SHI note receivable had a balance of $0.9 million. For the three months ended March 31, 2012 and 2011, interest income related to the note receivable was $13,000 and $0.1 million, respectively. We determined that Servant is not a variable interest entity and there is no requirement to include this entity in our condensed consolidated balance sheets and condensed consolidated statements of operations.

**8. Note Receivable from Related Party**

On December 14, 2009, we made a participating first mortgage loan commitment of $8.0 million to Nantucket Acquisition LLC ("Nantucket Acquisition"), a Delaware limited liability company owned and managed by Cornerstone Ventures Inc., an affiliate of our Advisor. The loan was made in connection with Nantucket Acquisition's purchase of a 60-unit senior living community, Sherburne Commons Residences, LLC ("Sherburne Commons"), located on the island of Nantucket, MA. The loan matures on January 1, 2015, with no option to extend and bears interest at a fixed rate of 8.0% for the term of the loan. Interest is payable monthly with the principal balance due at maturity. Under the terms of the loan, we are entitled to receive additional interest in the form of a 40% participation in the appreciation in value of the property, which is calculated based on the net sales proceeds if the property is sold, or the property's appraised value, less ordinary disposition costs, if the property has not been sold by the time the loan matures. Prepayment of the loan is not permitted without our consent and the loan is not assumable.

Leasing activity at Sherburne Commons has been lower than originally anticipated and to preserve cash flow for operating requirements, the borrower suspended interest payments to us beginning in the first quarter of 2011. Consequently, we began recognizing interest income on a cash basis commencing in the first quarter of 2011. For the three months ended March 31, 2012 and 2011, interest income recognized on the note was $0 and $59,000, respectively.

In the second and fourth quarter of 2011 and the first quarter of 2012, the loan balance was increased by $0.3 million, $0.2 million and $0.1 million, respectively, to provide funds to meet Sherburne Commons' operating shortfalls. It is anticipated that additional disbursements may be required while efforts are made to increase occupancy and evaluate other alternatives to maximize the value of the property, including the potential disposition of the property.

Nantucket Acquisition is considered a variable interest entity because the equity owners of Nantucket Acquisition do not have sufficient equity at risk. Due to the suspension of interest payments by the borrower, we issued a notice of default to the borrower on June 30, 2011 and determined that we were the primary beneficiary of the VIE due to our enhanced ability to direct the activities of the VIE. The primary beneficiary of a VIE is required to consolidate the operations of the VIE. Consequently, we have consolidated the operations of the VIE as of June 30, 2011 and, accordingly, eliminated the note receivable from related party balance in consolidation (see Note 9).

As of October 19, 2011, the Sherburne Commons property met the requirements for reclassification to real estate held for sale. Consequently, the related assets and liabilities of the property are classified as assets of variable interest entity held for sale and liabilities of variable interest entity held for sale, respectively, on our condensed consolidated balance sheets. Operating results for the property have been reclassified to discontinued operations on our condensed consolidated statements of operations for the three months ended March 31, 2012.

On a quarterly basis, we evaluate the collectability of our note receivable from related party. Our evaluation of collectability involves judgment, estimates, and a review of the underlying collateral and borrower's business models and future cash flows from operations. For the three months ended March 31, 2012, we recorded an impairment charge of $1.1 million attributed to the variable interest entity held for sale (see Note 9). For the three months ended March 31, 2011, we did not record any impairment on the note receivable from related party.

The following table reconciles the note receivable from related party from January 1, 2012 to March 31, 2012 and from January 1, 2011 to March 31, 2011**:**

| | 2012 | 2011 |
|---|---|---|
| Balance at January 1, | $ — | $8,000,000 |
| Additions: | | |
| Additions to note receivable from related party | 125,000 | — |
| Deductions: | | |
| Repayments of note receivable from related party | — | — |
| Elimination of balance in consolidation of VIE | (125,000) | — |
| Balance at March 31, | $ — | $8,000,000 |

**9. Consolidation of Variable Interest Entity**

GAAP requires the consolidation of VIEs in which an enterprise has a controlling financial interest. A controlling financial interest has both of the following characteristics: (i) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (ii) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

In compliance with ASC 810, *Consolidation,* we continuously analyze and reconsider our initial determination of VIE status to determine whether we are the primary beneficiary by considering, among other things, whether we have the power to direct the activities of the VIE that most significantly impact its economic performance. Such activities would include, among other things, determining or limiting the scope or purpose of the VIE, selling or transferring property owned or controlled by the VIE, or arranging financing for the VIE. We also consider whether we have the obligation to absorb losses of the VIE or the right to receive benefits from the VIE.

As of March 31, 2012, we had a variable interest in one VIE in the form of a note receivable from Nantucket Acquisition in the amount of $8.7 million (see Note 8).

As a result of our issuing a notice of default with respect to the note, we determined that we were the primary beneficiary of the VIE. Therefore, we consolidated the operations of the VIE beginning June 30, 2011. Assets of the VIE may only be used to settle obligations of the VIE and creditors of the VIE have no recourse to the general credit of the Company.

As of October 19, 2011, the Sherburne Commons property was reclassified to real estate held for sale. Consequently, the related assets and liabilities of the property were classified as assets of variable interest entity held for sale and liabilities of variable interest entity held for sale on our condensed consolidated balance sheets as of March 31, 2012 and December 31, 2011. Operating results for the property have been reclassified to discontinued operations on our condensed consolidated statement of operations for the three months ended March 31, 2012.

Since the Sherburne Commons property was reclassified to held for sale in the fourth quarter of 2011, the real estate is recorded at the lower of carrying value or the estimated fair value of the asset, net of estimated selling costs. Since June 30, 2011, leasing activity has been lower than originally anticipated and we have continued to provide funds to meet Sherburne Commons' operating shortfalls. As a result, we reduced our cash flow forecasts for purposes of determining whether the property was impaired. As a result of expected reduced leasing activity which reduced our cash flow forecasts for Sherburne Commons, we were required to adjust the property to its estimated fair value, net of estimated selling costs resulting in an impairment charge of $4.8 million, which is classified in discontinued operations as impairment of real estate sold and asset held for sale on our consolidated statement of operations for the year ended December 31, 2011.

Since the fourth quarter of 2011, the Sherburne Commons property has been actively marketed to prospective third-party buyers. In the first quarter of 2012, we received a formal offer from an independent third party to acquire the property. Based upon this evidence and management's plan to sell the property, we determined that the offer approximates fair value. Consequently, we recorded an impairment charge of $1.1 million in the first quarter of 2012. Currently, the property is deemed to be a Level 2 asset as our estimate of fair value is based on a non-binding purchase offer. We do not believe that this asset is a Level 1 asset as a purchase and sale agreement has not been signed and the potential buyer may opt out of the transaction at its discretion.

**10. Payable to Related Parties**

Payable to related parties at March 31, 2012 and December 31, 2011 consists of expense reimbursements payable to the Advisor.

**11. Equity**

***Common Stock***

Our articles of incorporation authorize 290,000,000 shares of common stock with a par value of $0.001 and 10,000,000 shares of preferred stock with a par value of $0.001. As of March 31, 2012 and December 31, 2011, we had cumulatively issued approximately 20.9 million shares of common stock for a total of $167.1 million of gross proceeds, exclusive of shares issued under our distribution reinvestment plan. On November 23, 2010, we stopped making and accepting offers to purchase shares of our stock (see Note 2).

***Distributions***

Distributions paid to stockholders for the three months ended March 31, 2012 and 2011 were approximately $0 and $0.5 million, respectively, all of which was paid in cash. Total cash distributions paid for the three months ended March 31, 2011 were 100% funded from cash provided by operating activities.

We adopted a distribution reinvestment plan that allows our stockholders to have their distributions invested in additional shares of our common stock. We have registered 21,100,000 shares of our common stock for sale pursuant to the distribution reinvestment plan. The purchase price per share is 95% of the price paid by the purchaser for our common stock, but not less than $7.60 per share. As of March 31, 2012 and December 31, 2011, approximately 2.3 million shares had been issued under the distribution reinvestment plan. On November 23, 2010, our board of directors adopted a resolution to suspend the distribution reinvestment plan indefinitely effective December 14, 2010. As a result, distributions were paid entirely in cash during the period December 14, 2010 and March 31, 2011. Commencing with the April 2011 distributions, the board elected to pay distributions on a quarterly basis. However, due to cash constraints, the board elected to defer the second quarter 2011 distribution payment until the Company's cash position improves. The second quarter distribution of $0.5 million was paid in the fourth quarter of 2011. We cannot provide any assurance as to if or when we will resume our distribution reinvestment plan.

The following table shows the distributions declared during the three months ended March 31, 2012 and 2011:

| | Distributions Declared[2] | | | Cash Flows Provided by (Used in) Operating Activities |
|---|---|---|---|---|
| Period | Cash | Reinvested | Total | |
| First quarter 2011[1] | $454,000 | $ — | $454,000 | $ 481,000 |
| First quarter 2012 | $ — | $ — | $ — | $(800,000) |

(1) 100% of the distributions declared during the three months ended March 31, 2011 represented a return of capital for federal income tax purposes.

(2) In order to meet the requirements for being treated as a REIT under the Internal Revenue Code, we must pay distributions to our shareholders each taxable year equal to at least 90% of our net ordinary taxable income. Some of our distributions have been paid from sources other than operating cash flow, such as offering proceeds.

The declaration of distributions is at the discretion of our board of directors and our board will determine the amount of distributions on a regular basis. The amount of distributions will depend on our funds from operations, financial condition, capital requirements, annual distribution requirements under the REIT provisions of the Internal Revenue Code and other factors our board of directors deems relevant. On November 23, 2010, our board of directors resolved to lower our distributions to an annualized rate of $0.08 per share (1% based on a share price of $8.00). No distributions have been declared for periods after June 30, 2011. The rate and frequency of distributions is subject to the discretion of our board of directors and may change from time to time based on our operating results and cash flow.

From our inception in October 2004 through March 31, 2012, we declared aggregate distributions of $32.8 million. Our cumulative net loss and cumulative net cash provided by operating activities during the same period were $71.1 million and $3.9 million, respectively.

***Stock Repurchase Program***

On November 23, 2010, our board of directors concluded that we would not have sufficient funds available to us to continue funding share repurchases. Accordingly, our board of directors suspended repurchases under the program effective December 31, 2010. In January 2011, repurchases due to the death of a shareholder that were requested in 2010, prior to the suspension of the stock repurchase program were funded. We can make no assurance as to when and on what terms redemptions will resume. Our board has the authority to resume, suspend again, or terminate the share redemption program at any time upon 30 days written notice to our stockholders. Our board of directors may modify our stock repurchase program so that we can redeem stock using the proceeds from the sale of our real estate investments or other sources.

During the three months ended March 31, 2012, we did not redeem any shares pursuant to our stock repurchase program. We have received requests to redeem 7,243 shares during the three months ended March 31, 2012. However, due to the current suspension of the stock repurchase program, we were not able to fulfill any of these requests.

During the three months ended March 31, 2011, we redeemed shares pursuant to our stock repurchase program as follows:

| Period | Total Number of Shares Redeemed | Average Price Paid per Share |
|---|---|---|
| January 2011[(1)] | 46,096 | $ 7.99 |
| February 2011 | — | $ — |
| March 2011 | — | $ — |
| | 46,096 | |

(1) In January 2011, share redemptions due to the death of a shareholder that were requested in 2010, prior to the suspension of the stock repurchase program, and were made under the program.

***Employee and Director Incentive Stock Plan***

We have adopted an Employee and Director Incentive Stock Plan (the “Plan”) which provides for the grant of awards to directors, full-time employees, and other eligible participants that provide services to us. We have no employees, and we do not intend to grant awards under the Plan to persons who are not directors. Awards granted under the Plan may consist of nonqualified stock options, incentive stock options, restricted stock, share appreciation rights, and distribution equivalent rights. The term of the Plan is ten years. The total number of shares of common stock reserved for issuance under the Plan is equal to 10% of our outstanding shares of stock at any time.

Effective January 1, 2006, we adopted the provisions of FASB ASC 718-10, *Compensation – Stock Compensation*, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. As of March 31, 2012, we had granted to our independent, non-employee directors nonqualified stock options to purchase an aggregate of 80,000 shares of common stock, at an exercise price of $8.00 per share. Of these shares, 15,000 shares lapsed and were canceled on November 8, 2008 due to the resignation of one director from the board of directors on August 6, 2008.

Outstanding stock options became immediately exercisable in full on the grant date, will expire ten years after their grant date, and have no intrinsic value as of March 31, 2012. We did not incur any non-cash compensation expense for the three months ended March 31, 2012 and 2011, respectively. No stock options were exercised or canceled during the three months ended March 31, 2012 and 2011, respectively. We record compensation expense for non-employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model. These assumptions include the risk-free interest rate, the expected life of the options and the expected stock price volatility over the expected life of the options, and the expected distribution yield. Compensation expense for employee stock options is recognized ratably over the vesting term.

The expected life of the options is based on evaluations of expected future exercise behavior. The risk-free interest rate is based on the U.S. Treasury yield curve at the date of grant with maturity dates approximately equal to the expected term of the options at the date of grant. Volatility is based on historical volatility of our stock. The valuation model applied in this calculation utilizes highly subjective assumptions that could potentially change over time, including the expected stock price volatility and the expected life of an option. Therefore, the estimated fair value of an option does not necessarily represent the value that will ultimately be realized by an independent, non-employee director.

In connection with the registration of the shares in our Follow-On Offering, we have suspended the issuance of options to our independent, non-employee directors under the Plan, and we do not expect to issue additional options to our independent, non-employee directors pursuant to our offering.

Our equity compensation plan information as of March 31, 2012 and December 31, 2011 is as follows:

| Plan Category | Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights | Weighted Average Exercise Price of Outstanding Options, Warrants and Rights | Number of Securities Remaining Available for Future Issuance |
|---|---|---|---|
| Equity compensation plans approved by security holders | 65,000 | $ 8.00 | See footnote(1) |
| Equity compensation plans not approved by security holders | — | — | — |
| Total | 65,000 | $ 8.00 | See footnote(1) |

(1) Our Employee and Director Incentive Stock Plan was approved by our security holders and provides that the total number of shares issuable under the plan is a number of shares equal to ten percent (10%) of our outstanding common stock. The maximum number of shares that may be granted under the plan with respect to "incentive stock options" within the meaning of Section 422 of the Internal Revenue Code is 5,000,000. As of March 31, 2012 and December 31, 2011, there were approximately 23.0 million shares of our common stock issued and outstanding.

## 12. Related Party Transactions

Our company has no employees. Our Advisor is primarily responsible for managing our business affairs and carrying out the directives of our board of directors. We have an Advisory Agreement with the Advisor and a dealer manager agreement with PCC which entitle the Advisor and PCC to specified fees upon the provision of certain services with regard to the Offerings and investment of funds in real estate projects, among other services, as well as reimbursement for organizational and offering costs incurred by the Advisor and PCC on our behalf and reimbursement of certain costs and expenses incurred by the Advisor in providing services to us.

### *Advisory Agreement*

Under the terms of the Advisory Agreement, the Advisor will use commercially reasonable efforts to present to us investment opportunities to provide a continuing and suitable investment program consistent with the investment policies and objectives adopted by our board of directors. The Advisory Agreement calls for the Advisor to provide for our day-to-day management and to retain property managers and leasing agents, subject to the authority of our board of directors, and to perform other duties.

The fees and expense reimbursements payable to the Advisor under the Advisory Agreement are described below. As discussed below, we amended the Advisory Agreement on August 31, 2011 to reduce the asset management fee payable by us to our Advisor effective October 1, 2011.

<u>Organizational and Offering Costs.</u> Organizational and offering costs of our Offerings have been paid by the Advisor on our behalf and have been reimbursed to the Advisor from the proceeds of our Offerings. Organizational and offering costs consist of all expenses (other than sales commissions and the dealer manager fee) to be paid by us in connection with our Offerings, including our legal, accounting, printing, mailing and filing fees, charges of our escrow holder and other accountable offering expenses, including, but not limited to, (i) amounts to reimburse the Advisor for all marketing related costs and expenses such as salaries and direct expenses of employees of the Advisor and its affiliates in connection with registering and marketing our shares; (ii) technology costs associated with the offering of our shares; (iii) the costs of conducting our training and education meetings; (iv) the costs of attending retail seminars conducted by participating broker-dealers; and (v) payment or reimbursement of bona fide due diligence expenses. In no event will we have any obligation to reimburse the Advisor for organizational and offering costs totaling in excess of 3.5% of the gross proceeds from our Primary Offering and Follow-On Offering. At times during our offering stage, before the maximum amount of gross proceeds has been raised, the amount of organization and offering expenses that we incur, or that our Advisor and its affiliates incur on our behalf, may exceed 3.5% of the gross offering proceeds then raised. In no event will we have any obligation to reimburse the Advisor for organizational and offering costs totaling in excess of 3.5% of the gross proceeds from our public offerings at the conclusion of the Offerings.

As of March 31, 2012 and December 31, 2011, the Advisor and its affiliates had incurred on our behalf organizational and offering costs totaling approximately $5.6 million and $5.6 million, respectively, including approximately $0.1 million of organizational costs that were expensed and approximately $5.5 million of offering costs which reduce net proceeds of our offerings. Of this amount, $4.4 million reduced the net proceeds of our Primary Offering and $1.1 million reduced the net proceeds of our Follow-On Offering.

Acquisition Fees and Expenses. The Advisory Agreement requires us to pay the Advisor acquisition fees in an amount equal to 2.0% of the gross proceeds from our Offerings. We have paid the acquisition fees upon receipt of the gross proceeds from our Primary Offering and Follow-On Offering (excluding gross proceeds related to sales pursuant to our distribution reinvestment plan). However, if the Advisory Agreement is terminated or not renewed, the Advisor must return acquisition fees not yet allocated to one of our investments. In addition, we are required to reimburse the Advisor for direct costs the Advisor incurs and amounts the Advisor pays to third parties in connection with the selection and acquisition of a property, whether or not ultimately acquired. For the three months ended March 31, 2012 and 2011, the Advisor earned no acquisition fees.

Management Fees and Expenses. Prior to October 1, 2011, the Advisory Agreement required us to pay the Advisor a monthly asset management fee of one-twelfth of 1.0% of the Average Invested Assets (as defined in the Advisory Agreement). For the three months ended March 31, 2012 and 2011, the Advisor earned $0.2 million and $0.4 million, respectively, of asset management fees which were expensed and included in asset management fees and expenses in our condensed consolidated statements of operations. On August 31, 2011, we amended the Advisory Agreement to provide that, beginning on October 1, 2011, the asset management fee payable by us to our Advisor shall be reduced to a monthly rate of one-twelfth of 0.75% of our Average Invested Assets, as defined above.

In addition, we reimburse the Advisor for the direct and indirect costs and expenses incurred by the Advisor in providing asset management services to us, including personnel and related employment costs related to providing asset management services on our behalf. These fees and expenses are in addition to management fees that we pay to third-party property managers. For the three months ended March 31, 2012 and 2011, the Advisor was reimbursed $44,000 and $45,000, respectively, of such direct and indirect costs and expenses incurred on our behalf, which are included in asset management fees and expenses in our condensed consolidated statements of operations.

Operating Expenses. The Advisory Agreement provides for reimbursement of the Advisor's direct and indirect costs of providing administrative and management services to us. For the three months ended March 31, 2012 and 2011, $0.3 million and $0.2 million of such costs, respectively, were reimbursed and are included in general and administrative expenses in our condensed consolidated statements of operations.

Pursuant to provisions contained in our charter and in our Amended and Restated Advisory Agreement with our Advisor, our board of directors has the ongoing responsibility of limiting our total operating expenses for the trailing four consecutive quarters to amounts that do not exceed the greater of 2% of our average invested assets or 25% of our net income, calculated in the manner set forth in our charter, unless a majority of the directors (including a majority of the independent directors) has made a finding that, based on unusual and non-recurring factors that they deem sufficient, a higher level of expenses is justified (the "2%/25% Test"). In the event that a majority of the directors (including a majority of the independent directors) does not determine that such excess expenses are justified, our Advisor must reimburse to us the amount of the excess expenses paid or incurred (the "Excess Amount").

As previously disclosed, for the periods ended March 31, 2011, June 30, 2011, September 30, 2011 and December 31, 2011, our board of directors conditioned its findings that Excess Amounts for such periods were justified upon the Advisor agreeing to carry over such Excess Amounts and include them in total operating expenses in subsequent periods for purposes of the 2%/25% Test, with any waiver of such amounts being dependent on our Advisor's satisfactory progress with respect to executing a strategic alternative to be chosen by the independent directors. Accordingly, for the seven-fiscal-quarter period ended December 31, 2011, our total operating expenses exceeded the greater of 2% of our average invested assets and 25% of our net income. We incurred operating expenses of approximately \$7.1 million and incurred an Excess Amount of approximately \$4.3 million during the seven quarters ended December 31, 2011, which has been carried over and included in the total operating expenses for the eight-fiscal-quarter period ended March 31, 2012 for purposes of the 2%/25% Test.

For the eight-fiscal-quarter period ended March 31, 2012, our total operating expenses again exceeded the greater of 2% of our average invested assets and 25% of our net income. We incurred operating expenses of approximately \$8.3 million and incurred an Excess Amount of approximately \$5.7 million during the eight quarters ended March 31, 2012. Our board of directors (including a majority of our independent directors) has determined that this Excess Amount is justified as unusual because of our small size (for a public reporting company) and non-recurring because of (i) the Advisor's current progress toward developing strategic alternatives for consideration by the independent directors, and (ii) the independent directors committee's continuing progress towards negotiating reductions in ongoing fees and expenses payable to the Advisor pursuant to the Amended and Restated Advisory Agreement. However, notwithstanding such justification, and as a condition to such justification, the Advisor has again agreed that the Excess Amount for the eight-fiscal-quarter period ended March 31, 2012 shall be carried over and included in total operating expenses in subsequent periods, with any waiver dependent on our Advisor's satisfactory progress with respect to executing a strategic alternative to be chosen by the independent directors.

Property Management Fees. The Advisory Agreement provides that if we retain our Advisor or an affiliate to manage and lease some of our properties, we will pay a market-based property management fee or property leasing fee, which may include reimbursement of our Advisor's or affiliate's personnel costs and other costs of managing the properties. For the three months ended March 31, 2012 and 2011, the Advisor earned approximately \$2,000 and \$5,000, respectively, of such property management fees. These costs are included in property operating and maintenance expenses in our condensed consolidated statements of operations.

Disposition Fee. Prior to the second amendment to the Amended and Restated Advisory Agreement executed on November 11, 2011, the Advisory Agreement provided that if the Advisor or its affiliates provide a substantial amount of the services (as determined by a majority of our directors, including a majority of our independent directors) in connection with the sale of one or more properties, we will pay the Advisor or such affiliate a disposition fee up to 3% of the sales price of such property or properties upon closing. This disposition fee may be paid in addition to real estate commissions paid to non-affiliates, provided that the total real estate commissions (including such disposition fee) paid to all persons by us for each property shall not exceed an amount equal to the lesser of (i) 6% of the aggregate contract sales price of each property or (ii) the competitive real estate commission for each property. We will pay the disposition fees for a property at the time the property is sold. For the three months ended March 31, 2012 and 2011, the Advisor did not earn and we did not incur any of such fees. Subsequent to November 11, 2011, the disposition fee was changed from up to 3% of the sales price of properties sold to up to 1% of the sales price of properties sold if the Advisor or its affiliates provide a substantial amount of the services (as determined by a majority of our directors, including a majority of our independent directors).

Subordinated Participation Provisions. The Advisor is entitled to receive a subordinated participation upon the sale of our properties, listing of our common stock or termination of the Advisor, as follows:

- After stockholders have received cumulative distributions equal to \$8.00 per share (less any returns of capital) plus cumulative, non-compounded annual returns on net invested capital, the Advisor will be paid a subordinated participation in net sale proceeds ranging from a low of 5% of net sales proceeds provided investors have earned annualized returns of 6% to a high of 15% of net sales proceeds if investors have earned annualized returns of 10% or more.
- Upon termination of the Advisory Agreement, the Advisor will receive the subordinated performance fee due upon termination. This fee ranges from a low of 5% of the amount by which the sum of the appraised value of our assets minus our liabilities on the date the Advisory Agreement is terminated plus total distributions (other than stock distributions) paid prior to termination of the Advisory Agreement exceeds the amount of invested capital plus annualized returns of 6%, to a high of 15% of the amount by which the sum of the appraised value of our assets minus our liabilities plus all prior distributions (other than stock distributions) exceeds the amount of invested capital plus annualized returns of 10% or more.

- In the event we list our stock for trading, the Advisor will receive a subordinated incentive listing fee instead of a subordinated participation in net sales proceeds. This fee ranges from a low of 5% of the amount by which the market value of our common stock plus all prior distributions (other than stock distributions) exceeds the amount of invested capital plus annualized returns of 6%, to a high of 15% of the amount by which the sum of the market value of our common stock plus all prior distributions (other than stock distributions) exceeds the amount of invested capital plus annualized returns of 10% or more.

***Dealer Manager Agreement***

PCC, as dealer manager, is entitled to receive sales commissions of up to 7% of gross proceeds from sales in our Offerings. PCC, as dealer manager, is also entitled to receive a dealer manager fee equal to up to 3% of gross proceeds from sales in the Offerings. The dealer manager is also entitled to receive a reimbursement of bona fide due diligence expenses up to 0.5% of the gross proceeds from sales in the Offerings. The Advisory Agreement requires the Advisor to reimburse us to the extent that offering expenses including sales commissions, dealer manager fees and organization and offering expenses (but excluding acquisition fees and acquisition expenses discussed above) are in excess of 13.5% of gross proceeds from the Offerings when combined with the shares sold under the related distribution reinvestment plan. For the three months ended March 31, 2012 and 2011, our dealer manager earned no sales commissions and dealer manager fees. Dealer manager fees and sales commissions paid to PCC are a cost of capital raised and, as such, are included as a reduction of additional paid-in capital in the accompanying condensed consolidated balance sheets.

## 13. Notes Payable

We have total debt obligations of $13.4 million that will mature in February and November of 2014. In connection with our notes payable, we incurred financing costs totaling approximately $0.4 million and $0.9 million, as of March 31, 2012 and December 31, 2011, respectively. These financing costs have been capitalized and are being amortized over the life of their respective financing agreements. For the three months ended March 31, 2012 and 2011, approximately $61,000 and $84,000, respectively, of deferred financing costs were amortized and included in interest expense in our condensed consolidated statements of operations.

### HSH Nordbank AG

We amended our credit agreement with HSH Nordbank AG, New York Branch (“HSH Nordbank”) in a series of amendments extending the credit facility maturity date from September 20, 2010 to December 16, 2011. As a part of these amendments, we made a principal reduction payment and paid extension fees.

The July 2011 amendment to this credit agreement extended the maturity date from September 30, 2011 to December 16, 2011 and increased the margin spread over LIBOR from a range of 350 to 375 basis points to a fixed 375 basis points from June 1, 2011 to September 30, 2011 and to 400 basis points from October 1, 2011 to the maturity date. Additionally, this amendment eliminated our requirement to make principal reduction payments of $0.3 million in July, August, and September 2011, respectively. In connection with this extension and the sale of the Goldenwest property (see Note 15), we made a principal payment of $7.8 million.

On November 28, 2011, this loan was repaid in its entirety with a portion of the proceeds from the sale of the Mack Deer Valley and Pinnacle Park Business Center properties.

### Wells Fargo Bank, National Association

On November 13, 2007, we entered into a loan agreement with Wells Fargo Bank, National Association (“Wells Fargo Bank”), successor-by-merger to Wachovia Bank, N.A., to facilitate the acquisition of properties during our offering period. The terms of the loan agreement provided for a borrowing amount of up to $22.4 million, which was reduced to $15.9 million as of November 30, 2009, at an interest rate of 140 basis points over one-month LIBOR, secured by specified real estate properties. The loan agreement had a maturity date of November 13, 2010, and provided for prepayment without penalty. Through a series of amendments executed through June 30, 2011, we extended the maturity date from November 13, 2010 to August 13, 2011.

On August 12, 2011, the loan agreement was amended to extend the maturity to February 13, 2012. In connection with this amendment, the 2111 South Industrial Park property and Shoemaker Industrial Buildings were added to the loan collateral, and we made a principal payment of $0.5 million. The terms of the amended loan provide for two one-year extensions, subject to meeting certain loan-to-value and debt service coverage ratios and require monthly principal payments. Interest on the amended loan increased to 300 basis points over one-month LIBOR with a 150 basis point LIBOR floor.

On December 22, 2011, in connection with the sale of the 2111 South Industrial Park property (see Note 15), we made a principal payment of approximately $0.9 million.

On February 13, 2012, we amended our loan agreement with Wells Fargo Bank, extending the maturity date from February 13, 2012 to February 13, 2014. In connection with this amendment, we made a principal payment of $7.5 million and paid fees and expenses totaling approximately $65,000. The interest rate on the amended loan decreased from 300 basis points over one-month LIBOR to 200 basis points over one-month LIBOR, with the one-month LIBOR floor remaining fixed at 150 basis points. Any amounts repaid under the loan agreement may not be re-borrowed. All other terms of the loan agreement remain in full force and effect.

As of March 31, 2012 and December 31, 2011, we had net borrowings of approximately $6.8 million and $14.4 million under the loan agreement, respectively. The weighted average interest rate as of March 31, 2012 and December 31, 2011 was 4.01% and 2.54%, respectively. The loan agreement contains various reporting covenants, including providing periodic balance sheets, statements of income and expenses of borrower and each guarantor, statements of income and expenses and changes in financial position of each secured property and cash flow statements of borrower and each guarantor. As of March 31, 2012, we were in compliance with all financial covenants.

The principal payments due on the Wells Fargo Bank loan for April 1, 2012 to December 31, 2012 and for each of the five following years ended December 31 is as follows:

| Year | Principal Amount |
|---|---|
| April 1, 2012 to December 31, 2012 | $ 270,000 |
| 2013 | $ 360,000 |
| 2014 | $ 6,139,000 |
| 2015 | $ — |
| 2016 | $ — |
| 2017 and thereafter | $ — |

**Transamerica Life Insurance Company**

In connection with our acquisition of Monroe North Commerce Center, on April 17, 2008, we entered into an assumption and amendment of note, mortgage and other loan documents (the "Loan Assumption Agreement") with Transamerica Life Insurance Company ("Transamerica"). Pursuant to the Loan Assumption Agreement, we assumed the outstanding principal balance of approximately $7.4 million on the Transamerica secured mortgage loan. The loan matures on November 1, 2014 and bears interest at a fixed rate of 5.89% per annum. As of March 31, 2012 and December 31, 2011, we have an outstanding balance of approximately $6.6 million and $6.7 million, respectively, under this loan agreement. This Loan Assumption Agreement contains various reporting covenants including an annual income statement, rent roll, operating budget and narrative summary of leasing prospects for vacant spaces. As of March 31, 2012, we were in compliance with all reporting covenants. The monthly payment on this loan is approximately $50,370. During the three months ended March 31, 2012 and 2011, we incurred $0.1 million and $0.1 million of interest expense, respectively, related to this loan agreement.

The principal payments due on the Monroe North Commerce Center mortgage loan for April 1, 2012 to December 31, 2012 and for each of the five following years ended December 31 is as follows:

| Year | Principal Amount |
|---|---|
| April 1, 2012 to December 31, 2012 | $ 164,000 |
| 2013 | $ 230,000 |
| 2014 | $ 6,234,000 |
| 2015 | $ — |
| 2016 | $ — |
| 2017 and thereafter | $ — |

### 14. Commitments and Contingencies

We monitor our properties for the presence of hazardous or toxic substances. While there can be no assurance that a material environmental liability does not exist, we are not currently aware of any environmental liability with respect to the properties that would have a material effect on our consolidated financial condition, results of operations and cash flows. Further, we are not aware of any environmental liability or any unasserted claim or assessment with respect to an environmental liability that we believe would require additional disclosure or the recording of a loss contingency.

Our commitments and contingencies include the usual obligations of real estate owners and operators in the normal course of business. In the opinion of management, these matters are not expected to have a material impact on our consolidated financial condition, results of operations, and cash flows. We are also subject to contingent losses related to the notes receivable and the note receivable from related party. For further details see Note 7 and 8. We are not presently subject to any material litigation nor, to our knowledge, any material litigation threatened against us which if determined unfavorably to us would have a material effect on our consolidated financial statements.

## 15. Discontinued Operations

### *Divestitures*

In accordance with FASB ASC 360-10, *Property, Plant & Equipment*, we report results of operations from real estate assets that meet the definition of a component of an entity that have been sold, or meet the criteria to be classified as held for sale, as discontinued operations.

On June 14, 2011, one of our wholly-owned subsidiaries sold the Goldenwest property to Westminster Redevelopment Agency, a non-related party, for a purchase price of $9.4 million. Approximately $7.8 million in proceeds from the sale were used to pay down a portion of the HSH Nordbank credit facility. The operations of Goldenwest are presented in discontinued operations on our condensed consolidated statement of operations for the three months ended March 31, 2011.

On November 28, 2011, two of our wholly-owned subsidiaries sold the Mack Deer Valley and Pinnacle Park Business Center properties to a non-related party for a purchase price of $23.9 million. The proceeds were used, in part, to pay down the entire balance of the HSH Nordbank credit facility. The operations of these properties are presented in discontinued operations on our condensed consolidated statement of operations for the three months ended March 31, 2011.

On December 22, 2011, our wholly-owned subsidiary sold the 2111 South Industrial Park property for a purchase price of $0.9 million. A loss on sale of $29,000 was recognized in the fourth quarter of 2011. The proceeds were used to pay down the Well Fargo loan. The operations of this property are presented in discontinued operations on our condensed consolidated statement of operations for the three months ended March 31, 2011.

### *Properties Held for Sale*

In the fourth quarter of 2011, our board of directors authorized us to actively market the Sherburne Commons property, a VIE that we began consolidating on June 30, 2011 (see Note 9).

The assets and liabilities of properties for which we have initiated plans to sell, but have not yet sold as of March 31, 2012 and December 31, 2011 have been classified as assets of variable interest entity held for sale and liabilities of variable interest entity held for sale on the accompanying condensed consolidated balance sheets. As of March 31, 2012 and December 31, 2011, this represents the assets and liabilities of the Sherburne Commons property. The results of operations for the variable interest entity held for sale have been presented in discontinued operations on the accompanying condensed consolidated statement of operations for the three months ended March 31, 2012.

The following is a summary of the components of (loss) income from discontinued operations for the three months ended March 31, 2012 and 2011:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2012 | 2011 |
| Rental revenues, tenant reimbursements and other income | $ 390,000 | $ 880,000 |
| Operating expenses, real estate taxes, and interest expense | (700,000) | (369,000) |
| Depreciation and amortization | — | (303,000) |
| Impairment of real estate | (1,140,000) | — |
| (Loss) income from discontinued operations | $ (1,450,000) | $ 208,000 |

FASB ASC 360-10 requires that assets classified as held for sale be carried at the lesser of their carrying amount or estimated fair value, less estimated selling costs. Accordingly, we recorded an impairment charge of $1.1 million in the first quarter of 2012 to record the Sherburne Commons property at its estimated fair value, less estimated selling costs (see Notes 4 and 9).

The following table presents balance sheet information for the properties classified as held for sale as of March 31, 2012 and December 31, 2011.

| | March 31, 2012 | December 31, 2011 |
|---|---|---|
| Assets of variable interest entity held for sale: | | |
| Cash and cash equivalents | $ 49,000 | $ 95,000 |
| Investments in real estate, net | 3,906,000 | 5,045,000 |
| Accounts receivable, inventory and other assets | 308,000 | 232,000 |
| Assets of variable interest entity held for sale | $4,263,000 | $5,372,000 |
| Liabilities of variable interest entity held for sale: | | |
| Note payable | $1,332,000 | $1,332,000 |
| Loan payable | 196,000 | 127,000 |
| Accounts payable and accrued liabilities | 417,000 | 373,000 |
| Intangible lease liabilities, net | 145,000 | 145,000 |
| Interest payable | 183,000 | 142,000 |
| Liabilities of variable interest entity held for sale | $2,273,000 | $2,119,000 |

## 16. Segment Reporting

ASC 280-10, "*Segment Reporting*," establishes standards for reporting financial and descriptive information about an enterprise's reportable segments. As of and for the three months ended March 31, 2012, we report our operations under one reportable segment: Industrial. Our Industrial segment consists of nine multi-tenant industrial properties offering a combination of warehouse and office space adaptable to a broad range of tenants and uses typically catering to local and regional businesses.

We evaluate performance of the combined properties based on net operating income ("NOI"). NOI is a non-GAAP supplemental measure used to evaluate the operating performance of real estate properties. We define NOI as total rental revenues, tenant reimbursements and other income less property operating and maintenance expenses. NOI excludes interest income from notes receivable, general and administrative expense, asset management fees and expenses, real estate acquisition costs, depreciation and amortization, impairments, interest income, interest expense, and income from discontinued operations. We believe NOI provides investors relevant and useful information because it measures the operating performance of the REIT's real estate at the property level on an unleveraged basis. We use NOI to make decisions about resource allocations and to assess and compare property-level performance. We believe that net income (loss) is the most directly comparable GAAP measure to NOI. NOI should not be viewed as an alternative measure of operating performance to net income (loss) as defined by GAAP since it does not reflect the aforementioned excluded items. Additionally, NOI as we define it may not be comparable to NOI as defined by other REITs or companies, as they may use different methodologies for calculating NOI.

The following table reconciles NOI from net loss for the three months ended March 31, 2012 and 2011:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2012 | 2011 |
| Net loss | $ (2,683,000) | $ (772,000) |
| Interest income from notes receivable | (13,000) | (159,000) |
| General and administrative | 1,034,000 | 615,000 |
| Asset management fees and expenses | 215,000 | 415,000 |
| Depreciation and amortization | 381,000 | 530,000 |
| Interest expense | 266,000 | 291,000 |
| Loss (income) from discontinued operations | 1,450,000 | (208,000) |
| Net operating income | $ 650,000 | $ 712,000 |

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

The following "Management's Discussion and Analysis of Financial Condition and Results of Operations" should be read in conjunction with our financial statements and notes thereto contained elsewhere in this report. This section contains forward-looking statements, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based. These forward-looking statements generally are identified by the words "believes," "project," "expects," "anticipates," "estimates," "intends," "strategy," "plan," "may," "will," "would," "will be," "will continue," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. Forward-looking statements that were true at the time made may ultimately prove to be incorrect or false. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise. All forward-looking statements should be read in light of the risks identified in Part II, Item 1A herein and Part I, Item 1A of our annual report on Form 10-K for the year ended December 31, 2011 filed with the U.S. Securities and Exchange Commission (the "SEC").

### Overview

We were incorporated on October 22, 2004 for the purpose of engaging in the business of investing in and owning commercial real estate. On January 6, 2006, we commenced a public offering of a minimum of 125,000 shares and a maximum of 55,400,000 shares of our common stock, consisting of 44,400,000 shares for sale to the public and 11,000,000 shares for sale pursuant to our distribution reinvestment plan. We stopped making offers under our initial public offering on June 1, 2009 upon raising gross offering proceeds of approximately $172.7 million from the sale of approximately 21.7 million shares, including shares sold under the distribution reinvestment plan. On June 10, 2009, the SEC declared our follow-on offering effective and we commenced a follow-on offering of up to 77,350,000 shares of our common stock, consisting of 56,250,000 shares for sale to the public and 21,100,000 shares for sale pursuant to our dividend reinvestment plan.

On November 23, 2010, we informed our investors of several decisions made by the board of directors for the health of our REIT.

**The Offering**. Effective November 23, 2010, we stopped making and accepting offers to purchase shares of our stock while our board of directors evaluates strategic alternatives to maximize value.

**Suspension of Distribution Reinvestment Plan**. Our offerings included a distribution reinvestment plan under which our stockholders could elect to have all or a portion of their distributions reinvested in additional shares of our common stock. Consistent with the above decision with respect to the offerings, we suspended our distribution reinvestment plan effective on December 14, 2010. All distributions paid after December 14, 2010 have been and will be made in cash.

**Distributions**. Effective December 1, 2010, our board of directors resolved to reduce distributions on our common stock to an annualized rate of $0.08 per share (1% based on a share price of $8.00), from the prior annualized rate of $0.48 per share (6% based on a share price of $8.00), in order to preserve capital that may be needed for capital improvements, debt repayment or other corporate purposes. Distributions at this rate were declared for the first and second quarters of 2011. Further, in June 2011, the board decided, based on the financial position of the Company, to suspend the declaration of further distributions and to defer the payment of the second quarter 2011 distribution, which was paid in December 2011. No distributions have been declared for periods after June 30, 2011. The rate and frequency of distributions is subject to the discretion of our board of directors and may change from time to time based on our operating results and cash flow.

**Stock Repurchase Program**. After careful consideration of the proceeds that will be available from our distribution reinvestment plan in 2010, and an assessment of our expected capital expenditures, tenant improvement costs and other costs and obligations related to our investments, our board of directors concluded that we will not have sufficient funds available to us to prudently fund any redemptions during 2011. Accordingly, our board of directors approved an amendment to our stock repurchase program to suspend redemptions under the program, effective December 31, 2010. We can make no assurances as to when and on what terms redemptions will resume. The share redemption program may be amended, resumed, suspended again, or terminated at any time based in part on our cash and debt position.

We used the net proceeds from our initial public offering to invest primarily in multi-tenant industrial real estate located in major metropolitan markets in the United States. If we resume our follow-on offering, we intend to use the net proceeds from our follow-on offering to acquire additional real estate investments and pay down temporary acquisition financing on our existing assets.

As of March 31, 2012, we had raised $167.1 million of gross proceeds from the sale of 20.9 million shares of our common stock in our initial public offering and follow-on offering and had acquired thirteen properties, four of which were sold during 2011. Our revenues, which are comprised largely of rental income, include rents reported on a straight-line basis over the initial term of the lease. Our growth depends, in part, on our ability to increase rental income and other earned income from leases by increasing rental rates and occupancy levels and control operating and other expenses. Our operations are impacted by property-specific, market-specific, general economic and other conditions.

Our board of directors continues to evaluate and implement strategic alternatives to reposition the company and preserve and increase shareholders' value. Specifically, we sold the Goldenwest property in June 2011 for gross proceeds of $9.4 million and made a principal payment of $7.8 million on the HSH Nordbank credit facility. Additionally, we sold the Mack Deer Valley and Pinnacle Park Business Center properties in November 2011 for gross proceeds of approximately $23.9 million. The proceeds were used, in part, to pay down the remaining balance of the HSH Nordbank credit facility. In December 2011, we sold the 2111 South Industrial Park property for gross proceeds of $0.9 million. The proceeds were used to pay down the Wells Fargo Bank, National Association loan. Furthermore, in February 2012, we amended our loan agreement with Wells Fargo Bank, National Association. The amendment, executed upon our making a $7.5 million principal payment, extended the maturity date of the loan from February 13, 2012 to February 13, 2014 and reduced the interest rate from 300 basis points over one-month LIBOR to 200 basis points over one-month LIBOR, with the LIBOR floor remaining fixed at 150 basis points (see Note 13). We are continuing to pursue options for repaying our debt, including asset sales.

***Market Outlook — Real Estate and Real Estate Finance Markets***

Beginning in 2010, and continuing during 2011, significant and widespread concerns about credit risk and access to capital experienced during 2009 began to subside. Uncertainties created by a sluggish U.S. economy and global economic problems have depressed real estate demand. Increased trade volume in 2010 spurred some increase in leasing activity in select west coast industrial markets. However, if economic uncertainty persists, we may continue to experience significant vacancies and expect to be required to reduce rental rates on occupied space.

Despite recent positive economic indicators, both the national and most global economies have experienced continued volatility throughout 2010, 2011 and during the first quarter of 2012. These conditions, combined with stagnant business activity and low consumer confidence, have resulted in a challenging operating environment.

As a result of the decline in general economic conditions, the U.S. commercial real estate industry has experienced deteriorating fundamentals across most major property types and most geographic markets. These market conditions have and will likely continue to have a significant impact on our real estate investments. In addition, these market conditions have impacted our tenants' businesses, which makes it more difficult for them to meet current lease obligations and places pressure on them to negotiate favorable lease terms upon renewal in order for their businesses to remain viable. Increases in rental concessions given to retain tenants and maintain our occupancy level, which is vital to the continued success of our portfolio, has resulted in lower current cash flows from operations. Projected future declines in rental rates, slower or potentially negative net absorption of leased space and expectations of future rental concessions, including free rent to retain tenants who are up for renewal or to sign new tenants, are expected to result in additional decreases in cash flows from operations.

Until market conditions are more stable, we expect to continue to limit capital expenditures, focusing on those capital expenditures that preserve value and/or generate rental revenue. However, if we experience an increase in vacancies, we may incur costs to re-lease properties and pay leasing commissions.

### Critical Accounting Policies

There have been no material changes to our critical accounting policies as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the SEC except as discussed in Note 3 to our financial statements contained in this report.

### Results of Operations

As of March 31, 2012, we owned nine properties. During 2011, we owned thirteen properties, four of which were sold during the course of the year. These properties were acquired from June 2006 through August 2010. During 2011, we owned nine properties for a full year, one property for five and one-half months, two properties for eleven months, and one property for eleven and one-half months. In June 2011, we sold the Goldenwest property for gross proceeds of approximately $9.4 million. In November 2011, we sold the Mack Deer Valley and Pinnacle Park Business Center properties for gross proceeds of approximately $23.9 million. In December 2011, we sold the 2111 South Industrial Park property for gross proceeds of $0.9 million.

In October 2011, we reclassified the Sherburne Commons property as held for sale (see Note 9) and the results of its operations have been reported in discontinued operations.

***Three months ended March 31, 2012 and 2011***

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2012 | 2011 | $ Change | % Change |
| Rental revenues, tenant reimbursements & other income | $ 1,004,000 | $1,105,000 | $ (101,000) | (9.1%) |
| Property operating and maintenance | (354,000) | (393,000) | 39,000 | (9.9%) |
| Net operating income[(1)] | 650,000 | 712,000 | (62,000) | (8.7%) |
| Interest income from notes receivable | 13,000 | 159,000 | (146,000) | (91.8%) |
| General and administrative | (1,034,000) | (615,000) | (419,000) | 68.1% |
| Asset management fees and expenses | (215,000) | (415,000) | 200,000 | (48.2%) |
| Depreciation and amortization | (381,000) | (530,000) | 149,000 | (28.1%) |
| Interest expense | (266,000) | (291,000) | 25,000 | (8.6%) |
| Loss from continuing operations | (1,233,000) | (980,000) | (253,000) | 25.8% |
| (Loss) income from discontinued operations | (1,450,000) | 208,000 | (1,658,000) | (797.1%) |
| Net loss | (2,683,000) | (772,000) | (1,911,000) | 247.5% |
| Noncontrolling interests' share in losses | 303,000 | — | 303,000 | N/A |
| Net loss applicable to common shares | $(2,380,000) | $ (772,000) | $(1,608,000) | 208.3% |

(1) Net operating income ("NOI") is a non-GAAP supplemental measure used to evaluate the operating performance of real estate properties. We define NOI as total rental revenues, tenant reimbursements and other income less property operating and maintenance expenses. NOI excludes interest income from notes receivable, general and administrative expense, asset management fees and expenses, real estate acquisition costs, depreciation and amortization, impairments, interest income, interest expense, and income from discontinued operations. We believe NOI provides investors relevant and useful information because it measures the operating performance of the REIT's real estate at the property level on an unleveraged basis. We use NOI to make decisions about resource allocations and to assess and compare property-level performance. We believe that net income (loss) is the most directly comparable GAAP measure to NOI. NOI should not be viewed as an alternative measure of operating performance to net income (loss) as defined by GAAP since it does not reflect the

aforementioned excluded items. Additionally, NOI as we define it may not be comparable to NOI as defined by other REITs or companies, as they may use different methodologies for calculating NOI. See Note 16 for a summary table reconciling NOI from net loss.

Rental revenues, tenant reimbursements and other income decreased to $1.0 million for the three months ended March 31, 2012 from $1.1 million for the three months ended March 31, 2011. The decrease is primarily due to lower overall occupancy rates, lower average lease rental rates and longer lease-up periods for vacant space as a result of the current economic environment.

Property operating and maintenance expense was $0.3 million for the three months ended March 31, 2012 compared to $0.4 million for the three months ended March 31, 2011. The decrease was primarily due to lower property taxes, insurance, legal collection fees and consultants, partially offset by higher property management expense and a lower reversal of bad debt expense as the first quarter of 2011 benefited from the substantial collection of previously reserved tenant receivables, while only a small recovery was received in the first quarter of 2012.

Interest income from notes receivable decreased to $13,000 for the three months ended March 31, 2012 from $0.2 million for the three months ended March 31, 2011 primarily due to the lower outstanding balance for the Servant Healthcare Investments, LLC note (see Note 7) resulting in approximately $87,000 less interest income and non-payment of interest on the Nantucket Acquisition LLC loan in 2012 compared to approximately $50,000 in interest income for the three months ended March 31, 2011.

General and administrative expenses increased to $1.0 million for the three months ended March 31, 2012 from $0.6 million for the three months ended March 31, 2011. The increase is primarily due to increased legal fees, audit fees, professional fees, allocations, and regulatory filing costs.

Asset management fees decreased to $0.2 million for the three months ended March 31, 2012 from $0.4 million for the three months ended March 31, 2011. The lower asset management fees are attributed to the sale of four properties in 2011 combined with a reduction in the annual asset management fee basis from 1.0% to 0.75% of the Average Invested Assets (as defined in the Advisory Agreement).

Depreciation and amortization decreased to $0.4 million for the three months ended March 31, 2012 from $0.5 million for the three months ended March 31, 2011 largely as a result of property impairments recorded in the second quarter of 2011.

Interest expense experienced a small decrease for the three months ended March 31, 2012 from $0.3 million for the three months ended March 31, 2011. The decrease is primarily due to lowering our overall outstanding principal balance of our debt obligations as a result of the $13.1 million repayment of the HSH Nordbank credit facility in 2011 and principal repayments on the Wells Fargo Bank loan of $2.9 million during 2011 and $7.5 million during the first quarter of 2012, partially offset by increasing interest rates during 2011 as a result of the HSH Nordbank and Wells Fargo Bank note extensions and related amortization of deferred financing costs associated with each extension.

The (loss) income from discontinued operations represents the results of operations for properties sold and/or classified as held for sale in accordance with ASC 360-10, *Property, Plant and Equipment.* Additionally, all prior periods presented for these properties were reclassified to discontinued operations for presentation purposes. During 2011, we sold our 15172 Goldenwest Circle, Mack Deer Valley, Pinnacle Park Business Center, and 2111 South Industrial Park properties to third parties and classified our VIE as held for sale. The loss from discontinued operations was $1.5 million for the three months ended March 31, 2012 compared to income from discontinued operations of $0.2 million for the three months ended March 31, 2011. The change is primarily attributed to operating losses and a $1.1 million impairment of our VIE held for sale during the three months ended March 31, 2012 compared to net income earned during the three months ended March 31, 2011 from the four properties which were sold in later months of 2011.

## Liquidity and Capital Resources

On November 23, 2010, our board of directors made a decision to stop making or accepting offers to purchase shares of our stock in our follow-on offering while evaluating strategic alternatives to maximize value and preserve the capital of our stockholders. During this time, we expect the primary sources of cash to be rental revenues, tenant reimbursements and interest income. In addition, we may receive sources of cash through the sale of additional properties. We expect our primary uses of cash to be for the repayment of principal on notes payable, funding of future acquisitions, payment of tenant improvements and leasing commissions, operating expenses, interest expense on outstanding indebtedness, advances to our VIE to fund operating shortfalls, and cash distributions. Operating expenses are expected to exceed operating revenues over the next twelve months. We plan to fund this operating shortfall from available cash and the net proceeds from property sales.

On January 6, 2006, we commenced an initial public offering of up to 55,400,000 shares of our common stock, consisting of 44,400,000 shares for sale pursuant to a primary offering and 11,000,000 shares for sale pursuant to our distribution reinvestment plan. We stopped making offers under our initial public offering on June 1, 2009. On June 10, 2009, we commenced a follow-on offering of up to 77,350,000 shares of our common stock, consisting of 56,250,000 shares for sale pursuant to a primary offering and 21,100,000 shares for sale pursuant to our dividend reinvestment plan. As of March 31, 2012, a total of approximately 20.9 million shares of our common stock had been sold in our combined offerings for aggregate gross proceeds of approximately $167.1 million. Our board of directors is currently evaluating strategic alternatives for our follow-on offering, but we do not expect our follow-on offering to be a material source of capital until such evaluation is completed.

As of March 31, 2012, we had approximately $8.9 million in cash and cash equivalents on hand.

*Credit Facilities and Loan Agreements*

As of March 31, 2012, we had total debt obligations of $13.4 million that mature in February and November of 2014. Of this amount, $6.8 million was outstanding on a loan agreement with Wells Fargo Bank, National Association (“Wells Fargo Bank”) and $6.6 million was outstanding on a loan agreement with Transamerica Life Insurance Company.

On November 28, 2011, the HSH Nordbank credit facility was repaid in its entirety with proceeds from the sale of the Mack Deer Valley and Pinnacle Park Business Center properties (see Notes 13 and 15).

In February 2012, we amended our loan agreement with Wells Fargo Bank to extend the maturity date to February 13, 2014. In connection with this amendment, we made a principal payment of $7.5 million, reducing the outstanding principal amount of our obligations under the loan agreement from $14.3 million to $6.8 million as of February 13, 2012, and paid fees and expenses totaling approximately $65,000. The interest rate on the amended loan decreased from 300 basis points over one-month LIBOR to 200 basis points over one-month LIBOR, with the one-month LIBOR floor remaining fixed at 150 basis points. Any amounts repaid under the loan agreement may not be re-borrowed. All other terms of the loan agreement remain in full force and effect.

*Short Term Liquidity Requirements*

In addition to the capital requirements for recurring capital expenditures, tenant improvements and leasing commissions, we may incur expenditures for future acquisitions and/or renovations of our existing properties, such as increasing the size of the properties by developing additional rentable square feet and/or making the space more appealing to potential industrial tenants.

We sold three properties in the fourth quarter of 2011 and currently have one property listed for sale to monetize our interest in our VIE, and we amended our loan agreement with Wells Fargo Bank in February 2012. We continue to pursue options for repaying our debt obligations, including asset sales. We believe that our cash and cash equivalents totaling $8.9 million as of March 31, 2012 will allow us to meet our obligations during the twelve months ending March 31, 2013. We expect to fund our short-term liquidity requirements primarily from available cash and future net sales proceeds.

*Distributions*

Effective December 1, 2010, our board of directors resolved to reduce distributions on our common stock to an annualized rate of $0.08 per share (1% based on a share price of $8.00), from the prior annualized rate of $0.48 per share (6% based on a share price of $8.00), in order to preserve capital that may be needed for capital improvements, debt repayment or other corporate purposes. Distributions at this rate were declared for the first and second quarters of 2011. In June 2011, the board decided, based on the financial position of the Company, to suspend the declaration of further distributions and to defer the payment of the second quarter 2011 distribution, which was paid in December 2011. No distributions have been declared for periods after June 30, 2011. The rate and frequency of distributions is subject to the discretion of our board of directors and may change from time to time based on our operating results and cash flow.

The following table shows the distributions declared during the three months ended March 31, 2012 and 2011:

| | Distributions Declared[2] | | | | Cash flows Provided by (Used in) |
|---|---|---|---|---|---|
| **Period** | **Cash** | **Reinvested** | **Total** | **Funds from Operations** | **Operating Activities** |
| First quarter 2011[1] | $454,000 | $ — | $454,000 | $ 61,000 | $ 481,000 |
| First quarter 2012 | $ — | $ — | $ — | $(859,000) | $(800,000) |

(1) 100% of the distributions declared during the three months ended March 31, 2011 represented a return of capital for federal income tax purposes.

(2) In order to meet the requirements for being treated as a REIT under the Internal Revenue Code, we must pay distributions to our shareholders each taxable year equal to at least 90% of our net ordinary taxable income. Some of our distributions have been paid from sources other than operating cash flow, such as offering proceeds.

From our inception in October 2004 through March 31, 2012, we declared aggregate distributions of $32.8 million. Our cumulative net loss and cumulative net cash provided by operating activities during the same period were $71.1 million and $3.9 million, respectively.

*Organization and offering costs*

As of March 31, 2012, our Advisor and its affiliates had incurred on our behalf organizational and offering costs totaling approximately $5.6 million, including approximately $0.1 million of organizational costs that were expensed and approximately $5.5 million of offering costs which reduced the net proceeds of our offerings. Of this amount, $4.4 million reduced the net proceeds of our initial public offering and $1.1 million reduced the net proceeds of our follow-on offering.

In no event will we have any obligation to reimburse the Advisor for these costs totaling in excess of 3.5% of the gross proceeds from our public offerings at the conclusion of the offerings. As of March 31, 2012 we had reimbursed our Advisor a total of $4.5 million in organizational and offering costs for our initial public offering and $1.1 million in organizational and offering costs for our follow-on offering.

At times during our offering stage, the amount of organization and offering costs that we incur, or that the Advisor and its affiliates incur on our behalf, may exceed 3.5% of the gross offering proceeds then raised, but our Advisor has agreed to reimburse us to the extent that our organization and offering costs exceed this 3.5% limitation at the conclusion of our offerings. In addition, the Advisor will pay all of our organization and offering costs that, when combined with the sales commissions and dealer manager fees that we incur exceed 13.5% of the gross proceeds from our public offerings. On November 23, 2010, we stopped making and accepting offers to purchase shares of our stock while our board of directors evaluates strategic alternatives to maximize stockholder value.

We will not rely on advances from the Advisor to acquire properties, but the Advisor and its affiliates may loan funds to special purpose entities that may acquire properties on our behalf pending our raising sufficient proceeds from our public offerings to purchase the properties from the special purpose entity.

In recent years, financial markets have experienced unusual volatility and uncertainty and liquidity has tightened in all financial markets, including the debt and equity markets. Our ability to repay or refinance debt could be adversely affected by an inability to secure financing at reasonable terms, if at all.

Other than the financial market conditions discussed above and market conditions discussed under the caption "Market Outlook—Real Estate and Real Estate Finance Markets," we are not aware of any material trends or uncertainties, favorable or unfavorable, affecting real estate generally, which we anticipate may have a material impact on either capital resources or the revenues or income to be derived from the operation of real estate properties.

**Funds from Operations and Modified Funds from Operations**

Funds from operations ("FFO") is a non-GAAP supplemental financial measure that is widely recognized as a measure of REIT operating performance. We compute FFO in accordance with the definition outlined by the National Association of Real Estate Investment Trusts ("NAREIT"). NAREIT defines FFO as net income (loss), computed in accordance with GAAP, excluding extraordinary items, as defined by the accounting principles generally accepted in the United States of America ("GAAP"), and gains (or losses) from sales of property, plus depreciation and amortization on real estate assets, and after adjustments for unconsolidated partnerships, joint ventures, noncontrolling interests and subsidiaries.

NAREIT recently issued updated reporting guidance that directs companies, for their computation of NAREIT FFO, to exclude impairments of depreciable real estate when write-downs are driven by measurable decreases in the fair value of real estate holdings. Previously, the Company's calculation of FFO (consistent with NAREIT's previous guidance) did not exclude impairments of, or related to, depreciable real estate. Consistent with this current NAREIT reporting guidance, the Company has restated its 2011 FFO amount.

Our FFO may not be comparable to FFO reported by other REITs that do not define the term in accordance with the current NAREIT definition or that interpret the current NAREIT definition differently than we do. We believe that FFO is helpful to investors and our management as a measure of operating performance because it excludes depreciation and amortization, gains and losses from property dispositions, and extraordinary items, and as a result, when compared year to year, reflects the impact on operations from trends in occupancy rates, rental rates, operating costs, development activities, general and administrative expenses, and interest costs, which is not immediately apparent from net income. Historical cost accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, many industry investors and analysts have considered the presentation of operating results for real estate companies that use historical cost accounting alone to be insufficient. As a result, our management believes that the use of FFO, together with the required GAAP presentations, provide a more complete understanding of our performance. Factors that impact FFO include start-up costs, fixed costs, delays in buying assets, lower yields on cash held in accounts pending investment, income from portfolio properties and other portfolio assets, interest rates on acquisition financing and operating expenses. FFO should not be considered as an alternative to net income (loss), as an indication of our performance, nor is it indicative of funds available to fund our cash needs, including our ability to make distributions.

Changes in the accounting and reporting rules under GAAP have prompted a significant increase in the amount of non-cash and non-operating items included in FFO, as defined. Therefore, we use modified funds from operations ("MFFO"), which excludes from FFO real estate acquisition costs, amortization of above- or below-market rents, and non-cash amounts related to straight-line rents and impairment charges to further evaluate our operating performance. We compute MFFO in accordance with the definition suggested by the Investment Program Association (the "IPA"), the trade association for direct investment programs (including non-listed REITs). However, certain adjustments included in the IPA's definition are not applicable to us and are therefore not included in the foregoing definition.

We believe that MFFO is an important supplemental measure of operating performance because it excludes costs that management considers more reflective of investing activities or non-operating changes. Accordingly, we believe that MFFO can be a useful metric to assist management, investors and analysts in assessing the sustainability of our operating performance. As explained below, management's evaluation of our operating performance excludes these items in the calculation based on the following considerations:

- **Real estate acquisition costs**. In evaluating investments in real estate, including both business combinations and investments accounted for under the equity method of accounting, management's investment models and analyses differentiate costs to acquire the investment from the operations derived from the investment. These acquisition costs have been funded from the proceeds of our initial public offering and other financing sources and not from operations. We believe by excluding expensed acquisition costs, MFFO provides useful supplemental information that is comparable for each type of our real estate investments and is consistent with management's analysis of the investing and operating performance of our properties. Real estate acquisition costs include those paid to our Advisor and to third parties.

- **Adjustments for amortization of above- or below-market rents**. Similar to depreciation and amortization of other real estate-related assets that are excluded from FFO, GAAP implicitly assumes that the value of lease assets diminishes predictably over time and that these charges be recognized currently in revenue. Since real estate values and market lease rates in the aggregate have historically risen or fallen with market conditions, management believes that by excluding these charges, MFFO provides useful supplemental information on the operating performance of our real estate.
- **Adjustments for straight-line rents**. Under GAAP, rental income recognition can be significantly different from underlying contract terms. By adjusting for these items, MFFO provides useful supplemental information on the economic impact of our lease terms and presents results in a manner more consistent with management's analysis of our operating performance.
- **Impairment charges**. Impairment charges relate to a fair value adjustment, which is based on the impact of current market fluctuations and underlying assessments of general market conditions and the specific performance of the holding, which may not be directly attributable to our current operating performance. As these losses relate to underlying long-term assets and liabilities, excluding real estate, where we are not speculating or trading assets, management believes MFFO provides useful supplemental information by focusing on the changes in our core operating fundamentals rather than changes that may reflect anticipated losses. In particular, because GAAP impairment charges are not allowed to be reversed if the underlying fair values improve or because the timing of impairment charges may lag the onset of certain operating consequences, we believe MFFO provides useful supplemental information related to the sustainability of rental rates, occupancy and other core operating fundamentals.

FFO and MFFO should not be considered as an alternative to net income (loss) or as an indication of our liquidity, nor is it indicative of funds available to fund our cash needs, including our ability to make distributions. Both FFO and MFFO should be reviewed along with other GAAP measurements. Our FFO and MFFO, as presented, may not be comparable to amounts calculated by other REITs.

The following is a reconciliation from net loss applicable to common shares, the most direct comparable financial measure calculated and presented with GAAP, to FFO and MFFO for the three months ended March 31, 2012 and 2011:

| | Three Months Ended March 31, 2012 | Three Months Ended March 31, 2011 |
|---|---|---|
| Net loss applicable to common shares | $ (2,380,000) | $ (772,000) |
| Adjustments: | | |
| Depreciation and amortization of real estate assets: | | |
| Continuing operations | 381,000 | 530,000 |
| Discontinued operations | — | 303,000 |
| Impairment of real estate assets: | | |
| Continuing operations | — | — |
| Discontinued operations | 1,140,000 | — |
| Noncontrolling interests' share in losses | (303,000) | — |
| Noncontrolling interests' share in FFO | 303,000 | — |
| Funds from operations (FFO) applicable to common shares | $ (859,000) | $ 61,000 |
| Adjustments: | | |
| Amortization of (below-) above-market rents | (7,000) | 4,000 |
| Straight-line rents | 11,000 | 32,000 |
| Amortization of deferred financing costs | 61,000 | 84,000 |
| Modified funds from operations (MFFO) applicable to common shares | $ (794,000) | $ 181,000 |
| Weighted-average number of common shares outstanding – basic and diluted | 23,028,284 | 23,039,808 |
| FFO per weighted average common shares | $ (0.04) | $ 0.00 |
| MFFO per weighted average common shares | $ (0.03) | $ 0.01 |

### Contractual Obligations

The following table reflects our contractual obligations as of March 31, 2012:

| | Payment due by period | | | | |
|---|---|---|---|---|---|
| Contractual Obligations | Total | Less than 1 year | 1-3 years | 4-5 years | More than 5 years |
| Notes payable[1] | $13,397,000 | $580,000 | $12,817,000 | $ — | $ — |
| Interest expense related to long-term debt[2] | $ 1,424,000 | $619,000 | $ 805,000 | $ — | $ — |
| Below-market ground lease[3][4] | $ 3,609,000 | $ — | $ 5,000 | $39,000 | $3,565,000 |

(1) This represents the sum of loan agreements with Wells Fargo Bank, National Association and Transamerica Life Insurance Company.

(2) Interest expense related to the loan agreement with Wells Fargo Bank, National Association is calculated based on the loan balance outstanding at March 31, 2012, one-month LIBOR at March 31, 2012, with a 150 basis point LIBOR floor, plus a margin of 200 basis points. Interest expense related to the loan agreement with Transamerica Life Insurance Company is based on a fixed rate of 5.89% per annum.

(3) The below-market ground lease relates to the Sherburne Commons property, a VIE for which we were deemed to be the primary beneficiary and began consolidating as of June 30, 2011. As of October 19, 2011, the Sherburne Commons property met the requirements for reclassification to real estate held for sale. Consequently, at March 31, 2012, the related assets and liabilities of the VIE are classified as assets of variable interest entity held for sale and liabilities of variable interest entity held for sale, respectively, on our condensed consolidated balance sheets.

(4) The below-market ground lease is a 50-year lease expiring in 2059 relating to land on which the Sherburne Commons senior housing facility is located. The land is leased from the town of Nantucket, Massachusetts with lease payments totaling $1 per year for years one through four, one-half of one percent of operating revenues, as defined in the ground lease, for years five through seven, and one percent of operating revenues, as defined in the ground lease, thereafter.

**Subsequent Event**

No significant events have occurred subsequent to our balance sheet date requiring further disclosure or adjustment to our balances.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Market risk includes risks that arise from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market sensitive instruments. We are exposed to the effects of interest rate changes as a result of borrowings used to maintain liquidity and to fund the acquisition, expansion and refinancing of our real estate investment portfolio and operations. Our profitability and the value of our investment portfolio may be adversely affected during any period as a result of interest rate changes. We invest our cash and cash equivalents in government-backed securities and FDIC-insured savings accounts which, by its nature, are subject to interest rate fluctuations. However, we believe that the primary market risk to which we will be exposed is interest rate risk related to our loan agreement.

We borrow funds and make investments at a combination of fixed and variable rates. Interest rate fluctuations will generally not affect our future earnings or cash flows on our fixed-rate debt or fixed-rate notes receivable unless such instruments mature or are otherwise terminated and/or need to be refinanced. However, interest rate changes will affect the fair value of our fixed-rate instruments. Conversely, changes in interest rates on variable-rate debt and investments would change our future earnings and cash flows, but not significantly affect the fair value of those instruments.

As of March 31, 2012, we had borrowings outstanding of approximately $6.8 million under our variable-rate loan agreement. An increase in the variable interest rate on the loan agreement constitutes a market risk as a change in rates would increase or decrease interest expense incurred and therefore cash flows available for distribution to shareholders. Based on the debt outstanding as of March 31, 2012, a one percent (1%) change in interest rates related to the variable-rate debt would result in a change in interest expense of approximately $68,000 per year, or approximately $0.003 per common share on a basic and diluted basis.

In addition to changes in interest rates, the value of our real estate is subject to fluctuations based on changes in the real estate capital markets, market rental rates for office space, local, regional and national economic conditions and changes in the creditworthiness of tenants. All of these factors may also affect our ability to refinance our debt, if necessary.

## Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports we file or submit under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our senior management, including our Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer), as appropriate, to allow timely decisions regarding required disclosure. Our Chief Executive Officer (Principal Executive Officer) and our Chief Financial Officer (Principal Financial Officer) have reviewed the effectiveness of our disclosure controls and procedures and have concluded that the disclosure controls and procedures were effective as of the end of the period covered by this report.

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer) are responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13(a)-15(f) under the Securities and Exchange Act of 1934. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

There have been no changes in our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II — OTHER INFORMATION

### Item 1A. Risk Factors

The following risk factors supplement the risks disclosed in our annual report on Form 10-K for the fiscal year ended December 31, 2011.

***We have paid, and may in the future, pay distributions from sources other than cash provided from operations.***

Until our investments in real estate generate operating cash flow sufficient to make distributions to stockholders, we may pay a substantial portion of our distributions from the proceeds of our offerings or from borrowings in anticipation of future cash flow. To the extent that we use offering proceeds to fund distributions to stockholders, the amount of cash available for investment in properties will be reduced. The distributions paid for the four quarters ended March 31, 2012 were approximately $0.6 million. Of this amount approximately $0 was reinvested through our dividend reinvestment plan and approximately $0.6 million was paid in cash to stockholders. For the four quarters ended March 31, 2012 net cash used in operating activities and funds from operations ("FFO") applicable to common shares were approximately $3.0 million and a loss of $2.1 million, respectively. Accordingly, for the four quarters ended March 31, 2012, total distributions exceeded cash flow from operations and FFO for the same period. We used offering proceeds to pay cash distributions in excess of cash flow from operations during the four quarters ended March 31, 2012.

***Any adverse changes in the financial health of our Advisor or its affiliates or our relationship with them could hinder our operating performance and the return on your investment. The dealer manager of our currently suspended public offering has recently experienced significant personnel reductions. As a result, we do not expect that we will be able to recommence our public offering unless and until we are able to engage a new dealer manager. We may have difficulty finding a qualified dealer manager and/or advisor, and any successor dealer manager or advisor may not be as well suited to manage us or our offering. These potential changes could result in a significant disruption of our business and may adversely affect the value of your investment in us.***

We are dependent on our Advisor to manage our operations and our portfolio of real estate assets. Our Advisor depends upon the fees and other compensation that it receives from us in connection with the purchase, management and sale of our properties to conduct its operations. To date, the fees we pay to our Advisor have been inadequate to cover its operating expenses. To cover its operational shortfalls, our Advisor has relied on cash raised in private offerings of its sole member. If our Advisor is unable to secure additional capital, it may become unable to meet its obligations and we might be required to find alternative service providers, which could result in a significant disruption of our business and may adversely affect the value of your investment in us. We may have difficulty finding a new qualified dealer manager, and any change in the dealer manager will require our public offering to remain suspended until regulatory approvals are obtained. Such a suspension could last months, and we cannot assure you that the necessary regulatory approvals would be obtained. In addition, any new dealer manager we engage may fail to raise significant capital. If we fail to raise significant capital, our portfolio will be less diversified and the value of your investment in us will vary more greatly with changes in the value of any one asset. Moreover, our general and administrative expenses will be greater in proportion to our assets, which will adversely affect your returns.

***Our stockholders have limited control over changes in our policies and operations, which increases the uncertainty and risks our stockholders face.***

Our board of directors determines our major policies, including our policies regarding investment, financing, growth, debt capitalization, REIT qualification and distributions. Our board of directors is currently engaged in a process of evaluating strategic alternatives to maximize value for our stockholders. As a result of this process, or otherwise, our board of directors may determine that it is in the best interest of the company to amend or revise certain of our major policies. Our board of directors may amend or revise these policies without a vote of the stockholders. Under Maryland General Corporation Law and our charter, our stockholders have a right to vote only on limited matters. Our board's broad discretion in setting policies and our stockholders' inability to exert control over those policies increases the uncertainty and risks our stockholders face.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(a) We did not sell any equity securities that were not registered under the Securities Act of 1933 during the period covered by this Form 10-Q.

(b) Not applicable.

(c) During the three months ended March 31, 2012, we redeemed no shares pursuant to our stock repurchase program, which was suspended effective December 31, 2010.

On November 23, 2010, our board of directors concluded that we would not have sufficient funds available to us to fund redemptions during 2011. Accordingly, our board of directors approved an amendment to our stock repurchase program to suspend redemptions under the program effective December 31, 2010. We can make no assurance as to when and on what terms redemptions will resume. The share redemption program may be amended, resumed, suspended again, or terminated at any time based in part on our cash and debt position. Our board has the authority to terminate the program at any time upon 30 days written notice to our stockholders.

During the three months ended March 31, 2012, we received requests to have an aggregate of 7,243 shares redeemed pursuant to our stock repurchase program. However, due to the current suspension of the stock repurchase program, we were not able to fulfill any of these requests.

## Item 6. Exhibits

| Ex. | Description |
|---|---|
| 3.1 | Amendment and Restatement of Articles of Incorporation (incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K filed on March 24, 2006). |
| 3.2 | Amended and Restated Bylaws (incorporated by reference to Exhibit 3.3 to Post-Effective Amendment No. 1 to the Registration Statement on Form S-11 (No. 333-121238) filed on December 23, 2005 ("Post-Effective Amendment No. 1")). |
| 4.1 | Subscription Agreement (incorporated by reference to Appendix A to the prospectus included on Post-Effective Amendment No. 2 to the Registration Statement on Form S-11 (No. 333-155640) filed on April 16, 2010 ("Post-Effective Amendment No. 2")). |
| 4.2 | Statement regarding restrictions on transferability of shares of common stock (to appear on stock certificate or to be sent upon request and without charge to stockholders issued shares without certificates) (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-11 (No. 333-121238) filed on December 14, 2004). |
| 4.3 | Amended and Restated Distribution Reinvestment Plan (incorporated by reference to Appendix B to the prospectus dated April 16, 2010 included on Post-Effective Amendment No. 2). |
| 31.1 | Certification of Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.1 | The following information from the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets; (ii) Condensed Consolidated Statements of Operations; (iii) Condensed Consolidated Statements of Cash Flows. |

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this quarterly report to be signed on its behalf by the undersigned, thereunto duly authorized this 15th day of May 2012.

CORNERSTONE CORE PROPERTIES REIT, INC.

By: /s/ Terry G. Roussel
Terry G. Roussel
*Chief Executive Officer*
*(Principal Executive Officer)*

By: /s/ Stephen I. Robie
Stephen I. Robie
*Chief Financial Officer*
*(Principal Financial Officer and Principal Accounting Officer)*

**Exhibit 31.1**

**CERTIFICATIONS OF PRINCIPAL EXECUTIVE OFFICER**

I, Terry G. Roussel, certify that:

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

Date: May 15, 2012

/s/ TERRY G. ROUSSEL
Terry G. Roussel
*Chief Executive Officer*
*(Principal Executive Officer)*

**Exhibit 31.2**

**CERTIFICATIONS OF PRINCIPAL FINANCIAL OFFICER**

I, Stephen I. Robie, certify that:

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

Date: May 15, 2012

/s/ STEPHEN I. ROBIE
Stephen I. Robie
*Chief Financial Officer*
*(Principal Financial Officer)*

**Exhibit 32**

CERTIFICATIONS PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Terry G. Roussel and Stephen I. Robie, do each hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of his and her knowledge, the Quarterly Report of Cornerstone Core Properties REIT, Inc. on Form 10-Q for the three-month period ended March 31, 2012 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents in all material respects the financial condition and results of operations of Cornerstone Core Properties REIT, Inc.

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|---|---|
| | /s/ TERRY G. ROUSSEL |
| Date: May 15, 2012 | Terry G. Roussel<br>*Chief Executive Officer*<br>*(Principal Executive Officer)* |
| | /s/ STEPHEN I. ROBIE |
| Date: May 15, 2012 | Stephen I. Robie<br>*Chief Financial Officer*<br>*(Principal Financial Officer)* |