

HARTMAN COMMERCIAL PROPERTIES REIT  
Form 424B3  
April 13, 2005

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Filed Pursuant to Rule 424(b)(3)  
Registration No. 333-111674

**PROSPECTUS SUPPLEMENT NO. 2**

**Dated April 6, 2005**

**(To Prospectus Dated September 15, 2004, as supplemented  
by Prospectus Supplement No. 1 dated October 12, 2004)**

**Hartman Commercial Properties REIT**  
**1450 West Sam Houston Parkway North, Suite 100**  
**Houston, Texas 77043-3124**  
**(713) 467-2222**

**Maximum Offering of 11,000,000 Common Shares of Beneficial Interest**  
**Minimum Offering of 200,000 Common Shares of Beneficial Interest**  
**Minimum Purchase of 100 Shares (\$1,000) in Most States**

*This document supplements, and should be read in conjunction with, the prospectus of Hartman Commercial Properties REIT dated September 15, 2004, as previously supplemented by Supplement No. 1 thereto dated October 12, 2004. Unless otherwise defined in this supplement, capitalized terms used in this supplement shall have the same meanings as set forth in the prospectus.*

The purposes of this Prospectus Supplement are as follows:

- (1) to update the status of our offering of common shares of beneficial interest in Hartman Commercial Properties REIT;
- (2) to revise the "Investment Objectives and Criteria Real Property Investments" section of the prospectus to describe the acquisition of Woodlake Plaza, an office building located in Houston, Texas; and
- (3) to provide you with a copy of our Annual Report on Form 10-K for the year ended December 31, 2004, as filed with the Securities and Exchange Commission on March 31, 2005, which amends and supplements certain information contained in the prospectus, as further described herein.

Any statement contained in the prospectus shall be deemed to be modified or superseded to the extent that information in this prospectus supplement modifies or supersedes such statement. Any statement that is modified or superseded shall not be deemed to constitute a part of the prospectus except as modified or superseded by this prospectus supplement.

This prospectus supplement should be read in conjunction with, and may not be delivered or utilized without, the prospectus, as supplemented. This prospectus supplement is qualified by reference to the prospectus, as supplemented, except to the extent that information contained in this prospectus supplement supersedes the information contained therein. Capitalized terms used and not defined herein shall have the meanings given to them in the prospectus.

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**Neither the Securities and Exchange Commission, the Attorney General of the State of New York nor any state securities regulator has approved or disapproved of these securities or determined if this prospectus, as supplemented, is truthful or complete. Any representation to the contrary is a criminal offense.**

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Investing in our common shares involves a high degree of risk. You should purchase common shares only if you can afford a complete loss of your investment. See "Risk Factors" beginning on page 17 of the attached prospectus for a discussion of these risks.

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The date of this Prospectus Supplement is April 6, 2005

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## Status of the Offering

Our Registration Statement on Form S-11 (SEC File No. 333-111674) was declared effective by the SEC on September 15, 2004 with respect to the Public Offering described in the prospectus of up to 10,000,000 shares of the Company's common stock to the public at a price of \$10 per share, plus up to 1,000,000 shares available for sale pursuant to our dividend reinvestment plan, to be offered at a price of \$9.50 per share, and the Company commenced the Public Offering on such date.

The 10,000,000 shares offered to the public in the Public Offering are being offered to investors on a best efforts basis, which means that the broker-dealers participating in the offering are only required to use their best efforts to sell the shares and have no firm commitment or obligation to purchase any of the shares.

As of December 31, 2004, no shares had been issued pursuant to the Public Offering, because its terms provided that the Company would not admit new shareholders pursuant to the Public Offering, or receive any proceeds therefrom, until subscriptions aggregating at least \$2,000,000 (200,000 shares) were received and accepted by the Company, not including shares sold to residents of either New York or Pennsylvania. As of December 31, 2004, we had received and accepted subscriptions for a total of 147,432 shares for gross offering proceeds of \$1,474,320 held in escrow as of such date.

As of April 1, 2005, we had accepted subscriptions for 546,481 shares (not including shares sold to residents of either New York or Pennsylvania) and, accordingly, 546,481 shares had been issued pursuant to the Public Offering as of such date with gross offering proceeds received of \$5,464,810. After subtracting offering expenses of \$688,245 (including \$442,329 in selling commissions, dealer manager fees and discounts, \$136,620 in offering expenses reimbursed to the Management Company and \$109,296 in acquisition fees paid to the Management Company), net proceeds were \$4,776,565.

\$1,550,000 of these proceeds were applied to reduce our balance under our line of credit with Union Planters Bank, N.A. This revolving loan agreement, under which the full balance is due for repayment June 30, 2005, provides for interest at a rate, adjusted monthly, of either (at our option) 30-day LIBOR plus 225 basis points, or Union Planter's Bank, N.A.'s prime rate less 50 basis points, with either rate subject to a floor of 3.75% per annum. The current effective interest rate is 4.96625% per annum. The remaining net proceeds of \$3,226,565 were allocated to working capital and funds available for investment.

## Real Property Investments

The section captioned "Investment Objectives and Criteria Real Property Investments" on page 79 of the prospectus is supplemented with the following information:

### *Woodlake Plaza*

On March 14, 2005, we purchased an office building containing approximately 106,169 rentable square feet located on an approximately 3.4963-acre tract of land in Houston, Texas ("Woodlake Plaza"). The total purchase price of Woodlake Plaza was \$5.5 million, plus closing costs, and was paid in cash with no assumption of debt. The purchase price for the transaction was determined through negotiations between CSFB 1998-P1 Gessner Office Limited Partnership, the seller, and us. In evaluating Woodlake Plaza as a potential acquisition and determining the appropriate amount of consideration to be paid by us, a variety of factors were considered, including the amount of rental income, expected capital expenditures, costs of maintenance, location, environmental issues, demographics, tenant mix, quality of tenants, length of leases, price per square foot, and occupancy. Our advisor and property manager, Hartman Management, L.P., believes that Woodlake Plaza is well located, has acceptable roadway access, attracts high-quality tenants, is well maintained and has been professionally managed. CSFB 1998-P1 Gessner Office Limited Partnership is not affiliated with us, Hartman REIT Operating Partnership, L.P., Hartman REIT Operating Partnership II, L.P., or Hartman Management, L.P.

Hartman Management, L.P., our affiliated advisor and property manager, will manage and arrange for leasing of Woodlake Plaza. Among other things, Hartman Management will have the authority to negotiate and enter into leases of the property on our behalf, to incur costs and expenses, to pay property operating costs and expenses from property cash flow or reserves and to require that we provide sufficient funds for the payment of operating expenses. As compensation, Hartman Management will receive property management and leasing fees

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equal to what other management companies generally charge for the management and leasing of similar properties in the Houston, Texas area.

Woodlake Plaza was built 1975, and includes among its major tenants Hibernia Corporation, Management Alliance Group and Rock Solid Images.

Hibernia Corporation is a financial holding company that, through its banking and non-banking subsidiaries, principally Hibernia National Bank, provides an array of financial products and services throughout Louisiana and portions of Texas. As of December 31, 2004, Hibernia Corporation operated in 314 locations in 34 Louisiana parishes and 34 Texas counties and two mortgage loan production and retail brokerage services offices in southern Mississippi. Hibernia Corporation also maintains a transactional website that offers certain banking services online. The annual base rent payable under the Hibernia lease is \$15.50 per rentable square foot. The lease expires on October 31, 2012, and Hibernia has an option to extend its lease for a period of 10 years.

Management Alliance Group is a human resources and employment services firm providing staffing solutions in specific professional and technical skill sets to Fortune 500 corporations and other organizations in the United States. Management Alliance Group offers three kinds of staffing solutions: permanent placement, specialty/temporary and contract staffing. Management Alliance Group conducts its business from offices in Dallas, Houston and Austin, Texas; Atlanta, Georgia; Denver, Colorado; Phoenix, Arizona; Philadelphia, Pennsylvania, and Raleigh, North Carolina. The annual base rent payable under the Management Alliance Group lease is \$13.50 per rentable square foot. The lease expires on September 30, 2008.

Rock Solid Images provides solutions for seismic reservoir characterization, and specializes in the integration of surface seismic and borehole data to build seismic-scale models of reservoir properties such as porosity and fluid saturation. In addition to providing turn-key seismic reservoir studies, Rock Solid Images develops software for rock-physics and seismic modeling and seismic attribute calculation and classification via industry funded consortia. The annual base rent payable under the Rock Solid Images lease is \$13.00 per rentable square foot. The lease expires on July 31, 2009, and Rock Solid Images has an option to extend its lease for a period of 5 years.

The current aggregate annual base rent for all tenants in Woodlake Plaza is approximately \$1,370,403.

### **Annual Report on Form 10-K for the Year Ended December 31, 2004**

Attached hereto and incorporated by reference herein is our Annual Report on Form 10-K for the year ended December 31, 2004, which we filed with the U.S. Securities and Exchange Commission on March 31, 2005. The information contained in the Form 10-K amends and supplements certain information contained in the prospectus, including those sections entitled "Description of Real Estate and Operating Data" beginning on page 80 of the prospectus (see Item 2 of the Form 10-K); "Selected Financial Data" on page 87 of the prospectus (see Item 6 of Form 10-K); "Management's Discussion and Analysis of Financial Condition and Results of Operations" beginning on page 88 of the prospectus (see Item 7 of Form 10-K); and "Financial Information" beginning on page F-1 of the prospectus (see Item 8 of the Form 10-K).

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

[Mark One]

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

**For the fiscal year ended December 31, 2004**

**OR**

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

**For the transition period from            to**

**Commission File Number: 000-50256**

**Hartman Commercial Properties REIT**

(Exact Name of Registrant as Specified in Its Charter)

**Maryland**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**76-0594970**  
(I.R.S. Employer  
Identification No.)

**1450 West Sam Houston Parkway North, Suite 100, Houston, Texas 77043-3124**  
(Address of Principal Executive Offices) (Zip Code)  
Registrant's telephone number, including area code: **(713) 467-2222**

Securities registered pursuant to section 12(b) of the Act:

**None**

Securities registered pursuant to section 12(g) of the Act:

**Common Shares of Beneficial Interest, par value \$0.001 per share**

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

The aggregate market value of the voting stock held by nonaffiliates of the Registrant as of June 30, 2004 (the last business day of the Registrant's most recently completed second fiscal quarter) was \$64,337,462 assuming a market value of \$10 per share.

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As of March 22, 2005, the Registrant had 7,443,420 shares of common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

The Registrant incorporates by reference portions of its Definitive Proxy Statement for the 2005 Annual Meeting of Shareholders, which shall be filed no later than April 30, 2005, into Part III of this Form 10-K to the extent stated herein.

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HARTMAN COMMERCIAL PROPERTIES REIT  
FORM 10-K  
Year Ended December 31, 2004

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### Forward-Looking Statements

This annual report contains forward-looking statements, including discussion and analysis of the Company's financial condition, anticipated capital expenditures required to complete projects, amounts of anticipated cash distributions to its shareholders in the future and other matters. These forward-looking statements are not historical facts but are the intent, belief or current expectations of the Company's management based on its knowledge and understanding of the Company's business and industry. Forward-looking statements are typically identified by the use of terms such as "may," "will," "should," "potential," "predicts," "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates" or the negative of such terms and variations of these words and similar expressions. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond the Company's control, are difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements.

Forward-looking statements that were true at the time made may ultimately prove to be incorrect or false. You are cautioned to not place undue reliance on forward-looking statements, which reflect management's view only as of the date of this Form 10-K. The Company undertakes no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results. Factors that could cause actual results to differ materially from any forward-looking statements made in this Form 10-K include changes in general economic conditions, changes in real estate conditions, construction costs that may exceed estimates, construction delays, increases in interest rates, lease-up risks, inability to obtain new tenants upon the expiration of existing leases, and the potential need to fund tenant improvements or other capital expenditures out of operating cash flow. The forward-looking statements should be read in light of these factors and the factors identified in the "Risk Factors" section of the Company's Registration Statement on Form S-11, as amended, as previously filed with the Securities and Exchange Commission.

## PART I

### Item 1. Business.

#### *General Development of Business*

Hartman Commercial Properties REIT (the "Company") is a Maryland real estate investment trust organized in December 2003 for the purpose of merging with Hartman Commercial Properties REIT, a Texas real estate investment trust organized in August 1998. On June 4, 2004, the shareholders of the Texas entity approved the merger, and on July 28, 2004, the reorganization was completed. We are the surviving entity as a result of the merger. The sole purpose of the reorganization was to change our state of domicile to Maryland by the conversion of each outstanding common share of beneficial interest of the Texas entity into 1.42857 common shares of beneficial interest of the Maryland entity. The Company has made an election to be taxed as a real estate investment trust ("REIT"). The Company invests in and operates retail, industrial and office properties located primarily in the Houston and San Antonio metropolitan areas, and plans to expand its investments to retail, office and industrial properties located in major metropolitan cities in the United States, principally in the Southern United States. The Company intends to lease each respective property to one or more tenants. In addition, the Company may make or invest in mortgage loans consistent with its REIT status.

Substantially all of the Company's business is conducted through Hartman REIT Operating Partnership, L.P., a Delaware limited partnership organized in 1998 (the "Operating Partnership"). The Company is the owner of a 53.37% interest in the Operating Partnership and is the sole general partner of the Operating Partnership.

The Company's advisor is Hartman Management, L.P. (the "Management Company"), a Texas limited partnership formed in 1990. The Management Company is an affiliate of the Company. The Management Company is responsible for managing the Company's affairs on a day-to-day basis and for identifying and making acquisitions and investments on behalf of the Company.

As of March 22, 2005, the Company had 7,443,420 common shares of beneficial interest (common stock) outstanding. As of such date, the Company had no shares of preferred stock issued and outstanding and no common stock equivalents outstanding. No stock options had been issued as of March 22, 2005.



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On December 31, 2004, the Company owned 34 properties. One additional property, containing approximately 106,169 feet of gross leasable area, was acquired on March 14, 2005. All of the Company's properties are located in the metropolitan Houston, Texas and San Antonio, Texas areas. The properties primarily consist of retail centers and each is designed to meet the needs of surrounding local communities. A supermarket or one or more nationally and/or regionally recognized tenants typically anchors each of the properties. In the aggregate, at December 31, 2004 the properties contained approximately 2,635,000 square feet of gross leasable area.

As of December 31, 2004, the properties were approximately 86.2% leased. As of such date, anchor space at the properties, representing approximately 10.0% of total leasable area, was 91.4% leased, while non-anchor space, accounting for the remaining 90.0% balance, was approximately 85.6% leased. A substantial number of the tenants of the properties are local tenants. Indeed, 74.5% of the tenants are local tenants and 12.2% and 13.3% of the tenants are national and regional tenants, respectively.

Substantially all of the Company's revenues consist of base rents and percentage rents received under long-term leases. For the year ended December 31, 2004, total rents and other income were \$23,106,301 and percentage rents were \$-0-. Approximately 66.5% of all existing leases provide for annual increases in the base rental payments with a "step up" rental clause.

### ***Recent Developments***

#### *Initial Public Offering*

On September 15, 2004, the Company's Registration Statement on Form S-11, with respect to a public offering (the "Public Offering") of up to 10,000,000 common shares of beneficial interest to be offered at a price of \$10.00 per share, was declared effective under the Securities Act of 1933. The Registration Statement also covers up to 1,000,000 shares available for sale pursuant to our dividend reinvestment plan, to be offered at a price of \$9.50 per share. The shares are being offered to investors on a best efforts basis, which means that the broker-dealers participating in the offering are only required to use their best efforts to sell the shares and have no firm commitment or obligation to purchase any of the shares.

As of December 31, 2004, no shares had been issued pursuant to the Public Offering, because its terms provided that the Company would not admit new shareholders pursuant to the Public Offering, or receive any proceeds therefrom, until subscriptions aggregating at least \$2,000,000 (200,000 shares) were received and accepted by the Company, not including shares sold to residents of either New York or Pennsylvania. As of December 31, 2004, the Company had received and accepted subscriptions for a total of 147,432 shares for gross offering proceeds of \$1,474,320 held in escrow as of such date.

As of February 11, 2005, the Company had accepted subscriptions for 277,775 shares (not including shares sold to residents of either New York or Pennsylvania) and, accordingly, 277,775 shares had been issued pursuant to the Public Offering as of such date with gross offering proceeds received of \$2,777,750. The terms of the Public Offering provide that we will pay a dealer manager fee of up to 2.5% of the gross offering proceeds to D.H. Hill Securities, LLP, our dealer manager for the Public Offering, and also that we will pay selling commissions of up to 7.0% of the gross offering proceeds for any sales through participating broker-dealers and the dealer manager, other than sales by employees of the Management Company sponsored by the dealer manager. Additionally, in connection with the Public Offering, we have agreed to pay the Management Company, in its capacity as our advisor (i) up to 2.5% of the gross offering proceeds as reimbursement for the Management Company's payment of organization and offering expenses on behalf of the Company and (ii) an acquisition fee equal to 2.0% of the gross offering proceeds for its services in connection with the selection, purchase, development or construction of real property (payable upon receipt by the Company of such proceeds, rather than when a property is acquired). We accrued an aggregate of \$218,260 in dealer manager fees and selling commissions for the subscriptions accepted through February 11, 2005, resulting in net proceeds to the Company (after the payment of such fees and commissions) of \$2,559,490. Out of such net proceeds, we accrued amounts payable to the Management Company of \$69,444 as a reimbursement of organization and offering expenses and \$55,555 pursuant to the acquisition fee described above.

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Additional subscription proceeds will be held in escrow until investors are admitted as shareholders. We intend to admit new stockholders at least monthly pursuant to the Public Offering. At that time, subscription proceeds may be released to the Company from escrow and applied to the making of investments and the payment or reimbursement of the dealer manager fee, selling commissions and other organization and offering expenses. Until required for such purposes, net offering proceeds will be held in short-term, liquid investments.

### *Recent Acquisitions*

On September 8, 2004, the Company purchased Stafford Plaza, a retail shopping center containing approximately 95,032 rentable square feet located on an approximately 8.66-acre tract of land in Houston, Texas. The total purchase price of Stafford Plaza was \$8.9 million, plus closing costs, and was paid through cash drawn on the Company's line of credit. The purchase price for the transaction was determined through negotiations between STPL Associates LP, the seller, and the Company. STPL Associates LP is not affiliated with the Company, Hartman REIT Operating Partnership, L.P., Hartman REIT Operating Partnership II, L.P., or Hartman Management, L.P. Stafford Plaza, which was built in 1974, includes among its major tenants The TJX Companies, Inc., Blockbuster, Inc. and Exxon Mobil Corporation. The current aggregate annual base rent for all tenants in Stafford Plaza is approximately \$856,029.

On March 14, 2005, the Company purchased Woodlake Plaza, an office building containing approximately 106,169 rentable square feet located on an approximately 3.4963-acre tract of land in Houston, Texas. The total purchase price of Woodlake Plaza was \$5.5 million, plus closing costs, and was paid through cash drawn on the Company's line of credit. The purchase price for the transaction was determined through negotiations between CSFB 1998-P1 Gessner Office Limited Partnership, the seller, and the Company. CSFB 1998-P1 Gessner Office Limited Partnership is not affiliated with the Company, Hartman REIT Operating Partnership, L.P., Hartman REIT Operating Partnership II, L.P., or Hartman Management, L.P. Woodlake Plaza, which was built in 1975, includes among its major tenants Hibernia Corporation, Management Alliance Group and Rock Solid Images. The current aggregate annual base rent for all tenants in Woodlake Plaza is approximately \$1,370,403.

### *Investment Objectives and Criteria*

The following is an overview of our current policies with respect to investments, borrowing, affiliate transactions, equity capital and certain other activities. All of these policies have been established in our governance documents or by our management and may be amended or revised from time to time (and at any time) by our management or trustees without a vote or the approval of our shareholders. Any change to these policies would be made, however, only after a review and analysis of such change, in light of then existing business and other circumstances, and then only if we believe that it is advisable to do so in the best interest of our shareholders. We cannot assure you that our policies or investment objectives will be attained or that the value of our common shares will not decrease.

### *General*

We invest in commercial real estate properties, primarily neighborhood retail centers and office and industrial properties. Our primary business and investment objectives are:

to maximize cash dividends paid to our shareholders;

to continue to qualify as a REIT for federal income tax purposes;

to obtain and preserve long-term capital appreciation in the value of our properties to be realized upon our ultimate sale of such properties; and

to provide our shareholders with liquidity for their investment in us by listing our shares on the New York Stock Exchange, the American Stock Exchange, the Nasdaq National Market or another national exchange within twelve years after the completion of the Public Offering.

In addition, to the extent that our advisor determines that it is advantageous to make or invest in mortgage loans, we will also seek to obtain fixed income through the receipt of payments on mortgage loans. Our management intends to limit such mortgage investments to 15.0% of our total investment portfolio unless our management determines that prevailing economic or portfolio circumstances require otherwise. We cannot assure

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you that we will attain these objectives or that our capital will not decrease. Pursuant to our advisory agreement, our advisor will be indemnified for claims relating to any failure to succeed in achieving these objectives.

We may not materially change our investment objectives, except upon approval of shareholders holding a majority of the shares. Our independent trustees will review our investment objectives at least annually to determine that our policies are in the best interests of our shareholders. Each such determination will be set forth in the minutes of our board of trustees. Decisions relating to the purchase or sale of our investments will be made by the Management Company, as our advisor, subject to approval by our board of trustees, including a majority of our independent trustees.

### *Acquisition and Investment Policies*

We intend to continue to acquire community retail centers and office and industrial properties for long-term ownership and for the purpose of producing income. These are properties that generally have premier business addresses in especially desirable locations. Such properties generally are of high quality construction, offer personalized tenant amenities and attract higher quality tenants. We generally intend to hold our properties seven to ten years, which we believe is the optimal period to enable us to capitalize on the potential for increased income and capital appreciation of our properties. However, economic or market conditions may influence us to hold our investments for different periods of time. Also, it is our management's belief that targeting this type of property for investment will enhance our ability to enter into joint ventures with other institutional real property investors (such as pension funds, public REITs and other large institutional real estate investors), thus allowing greater diversity of investment by increasing the number of properties in which we invest. Our management also believes that a portfolio consisting of a preponderance of this type of property enhances our liquidity opportunities for investors by making the sale of individual properties, multiple properties or our investment portfolio as a whole attractive to institutional investors and by making a possible listing of our shares attractive to the public investment community.

We acquire assets primarily for income. Although we have historically invested in properties that have been constructed and have operating histories, we anticipate that we may become more active in investing in raw land or in properties that are under development or construction. To the extent feasible, we will invest in a portfolio of properties that will satisfy our investment objectives of maximizing cash available for payment of dividends, preserving our capital and realizing capital appreciation upon the ultimate sale of our properties.

Our policy is to continue to acquire properties in the Houston and San Antonio, Texas metropolitan areas where we believe opportunities exist for acceptable investment returns. We anticipate that we will continue to focus on properties in the \$1,000,000 to \$10,000,000 value range. We typically lease our properties to a wide variety of tenants on a "triple-net" basis which means that the tenant is responsible for paying the cost of all maintenance and minor repairs, property taxes and insurance relating to its leased space. Our management believes that its extensive experience, market knowledge and network of industry contacts in the Houston and San Antonio metropolitan areas, and the limitation of our investments to this area, gives us a competitive advantage and enhances our ability to identify and capitalize on acquisitions. Although we anticipate that we will continue to focus primarily on acquisition opportunities in Houston and San Antonio, Texas, we are also exploring opportunities in Texas outside of Houston and San Antonio. Specifically, we are exploring the feasibility of acquiring commercial real estate in Dallas, Texas.

Although, we currently intend to invest in or develop community retail centers and other office and industrial properties in the Houston and San Antonio metropolitan areas, our future investment or redevelopment activities are not limited to any geographic area or to a specified property use. We may invest in any geographic area and we may invest in other commercial properties such as manufacturing facilities, and warehouse and distribution facilities in order to reduce overall portfolio risk, enhance overall portfolio returns, or respond to changes in the real estate market if our advisor determines that it would be advantageous to do so. Further, to the extent that our advisor determines it is in our best interest, due to the state of the real estate market or in order to diversify our investment portfolio or otherwise, we may make or invest in mortgage loans secured by the same types of commercial properties in which we intend to invest. Our management intends to limit such mortgage investments to 15.0% of our total investment portfolio unless our management determines that prevailing economic or portfolio circumstances require otherwise.

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Although we are not limited as to the form our investments may take, all of our properties are owned by the Operating Partnership or by a wholly owned subsidiary of the Operating Partnership in fee simple title. We expect to continue to pursue our investment objectives through the direct ownership of properties. However, in the future, we may also participate with other entities (including non-affiliated entities) in property ownership, through joint ventures, limited liability companies, partnership, co-tenancies or other types of common ownership. We presently have no plans to own any properties jointly with another entity or entities. In addition, we may purchase properties and lease them back to the sellers of such properties. While we will use our best efforts to structure any such sale-leaseback transaction such that the lease will be characterized as a "true lease" so that we will be treated as the owner of the property for federal income tax purposes, we cannot assure you that the Internal Revenue Service will not challenge such characterization. In the event that any such sale-leaseback transaction is recharacterized as a financing transaction for federal income tax purposes, deductions for depreciation and cost recovery relating to such property would be disallowed.

We may also enter into arrangements with the seller or developer of a property whereby the seller or developer agrees that, if during a stated period the property does not generate a specified cash flow, the seller or developer will pay in cash to us a sum necessary to reach the specified cash flow level, subject in some cases to negotiated dollar limitations.

In determining whether to purchase a particular property, we may, in accordance with customary practices, obtain an option on such property. The amount paid for an option, if any, is normally surrendered if the property is not purchased and is normally credited against the purchase price if the property is purchased.

In purchasing, leasing and developing properties, the Company will be subject to risks generally incident to the ownership of real estate, including:

changes in general or local economic conditions;

changes in supply of or demand for similar or competing properties in an area;

changes in interest rates and availability of permanent mortgage funds that may render the sale of a property difficult or unattractive;

adverse changes in tax, real estate, environmental and zoning laws;

a taking of any of our properties by eminent domain;

acts of God, such as earthquakes or floods and other uninsured losses;

periods of high interest rates and tight money supply that may make the sale of properties more difficult;

a reduction in rental income as a result of the inability to maintain occupancy levels due to tenant turnover or tenant bankruptcies; and

general overbuilding or excess supply in the market area.

Some or all of the foregoing factors may affect our properties, which could adversely affect our operations and ability to pay dividends to shareholders. The Company and its performance will be subject to additional risks as have been listed in the Company's Registration Statement on Form S-11, as amended, as previously filed with the Securities and Exchange Commission.

### *Terms of Leases and Tenant Credit Worthiness*

While the terms and conditions of any lease that we enter into with our tenants may vary substantially from those described herein, we expect that a majority of our leases will be office leases customarily used between landlords and tenants in the geographic area where the property is located. Such leases generally provide for terms of three to five years and require the tenant to pay a pro rata share of building expenses. Under such typical leases,



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the landlord is directly responsible for all real estate taxes, sales and use taxes, special assessments, utilities, insurance and building repairs, and other building operation and management costs.

We will execute new tenant leases and tenant lease renewals, expansions and extensions with terms that are dictated by the current submarket conditions and the verifiable creditworthiness of each particular tenant. We will use a number of industry credit rating services to determine the creditworthiness of potential tenants and any personal guarantor or corporate guarantor of each potential tenant. The reports produced by these services will be compared to the relevant financial data collected from these parties before consummating a lease transaction. Our advisor will promulgate leasing guidelines for use by the Management Company in evaluating prospective tenants and proposed lease terms and conditions.

### *Borrowing Policies*

Most of our current properties are subject to mortgages. If we acquire a property for cash in the future, we will most likely fund a portion of the purchase price with debt. By operating and acquiring on a leveraged basis, we will have more funds available for investment in properties. This will allow us to make more investments than would otherwise be possible, resulting in a more diversified portfolio of assets. When interest rates on mortgage loans are high or financing is otherwise unavailable on a timely basis, we may purchase certain properties for cash with the intention of obtaining a mortgage loan for a portion of the purchase price at a later time.

Our organizational and governance documents generally limit the maximum amount of indebtedness that we may incur to 300% of our net assets as of the date of any borrowing. Notwithstanding the foregoing, we may exceed such borrowing limits if any excess in borrowing over such 300% level is approved by a majority of our independent trustees and disclosed to our shareholders in a subsequent quarterly report. Further, we do not have a policy limiting the amount of indebtedness we may incur or the amount of mortgages which may be placed on any one piece of property. As a general policy, however, we intend to maintain a ratio of total liabilities to total assets that is less than 50%. As of December 31, 2004, we had a ratio of total liabilities to total assets of 46.5%. However, we may not be able to continue to achieve this objective.

The Management Company will refinance properties during the term of a loan only in limited circumstances, such as when a decline in interest rates makes it beneficial to prepay an existing mortgage, when an existing mortgage matures or if an attractive investment becomes available and the proceeds from the refinancing can be used to purchase such investment. The benefits of the refinancing may include an increased cash flow resulting from reduced debt service requirements, an increase in dividend distributions from proceeds of the refinancing, and an increase in property ownership if refinancing proceeds are reinvested in real estate.

We may not borrow money from any of our trustees or from the Management Company and its affiliates unless such loan is approved by a majority of the trustees, including a majority of the independent trustees, not otherwise interested in the transaction as fair, competitive and commercially reasonable and no less favorable to us than a comparable loan between unaffiliated parties.

### *Disposition Policies*

We intend to hold each property that we acquire for an extended period, and we have no current intention to dispose of any of our properties. However, a property may be sold before the end of the expected holding period if, in the judgment of the Management Company, the value of the property might decline substantially, an opportunity has arisen to improve other properties, we can increase cash flow through the disposition of the property, or the sale of the property is in our best interests. The determination of whether a particular property should be sold or otherwise disposed of will be made after consideration of relevant factors, including prevailing economic conditions, with a view to achieving maximum capital appreciation. The selling price of a leased property will be determined in large part by the amount of rent payable by the tenants. The terms of payment will be affected by custom in the area in which the property being sold is located and the then-prevailing economic conditions.

If our shares are not listed for trading on the New York Stock Exchange, the American Stock Exchange, the Nasdaq National Market or another national exchange within twelve years of the termination of the Public Offering, unless such date is extended by the majority vote of both our board of trustees and our independent trustees, our Declaration of Trust requires us to begin the sale of all of our properties and distribution to our shareholders of the

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net sale proceeds resulting from our liquidation. If at any time after twelve years of the termination of the Public Offering we are not in the process of either (i) listing our shares for trading on a national securities exchange or including such shares for quotation on the Nasdaq Stock Market or (ii) liquidating our assets, investors holding a majority of our shares may vote to liquidate us in response to a formal proxy to liquidate. Depending upon then prevailing market conditions, it is our intention to begin to consider the process of listing or liquidation prior to the twelfth anniversary of the termination of the Public Offering. In making the decision to apply for listing of our shares, the trustees will try to determine whether listing our shares or liquidating our assets will result in greater value for our shareholders. The circumstances, if any, under which the trustees will agree to list our shares cannot be determined at this time. Even if our shares are not listed or included for quotation, we are under no obligation to actually sell our portfolio within this period since the precise timing will depend on real estate and financial markets, economic conditions of the areas in which the properties are located and federal income tax effects on shareholders that may prevail in the future. We may not be able to liquidate our assets. We will continue in existence until all properties are sold and our other assets are liquidated.

### *Securities of or Interests in Persons Primarily Engaged in Real Estate Activities and Other Issuers*

Consistent with the requirements necessary to maintain our qualification as a REIT for Federal income tax purposes, we may acquire securities of entities engaged in real estate activities or securities of other issuers, including for the purpose of exercising control over such entities. We may acquire all or substantially all of the securities or assets of REITs or similar entities where such investments would be consistent with our investment policies. We anticipate that we will only acquire securities or other interests in issuers engaged in commercial real estate activities involving retail, office or industrial properties. We may also invest in entities owning undeveloped acreage. Neither our Declaration of Trust nor our bylaws place any limit or restriction on the percentage of our assets that may be invested in securities of or interests in other issuers. The governance documents of the Operating Partnership also do not contain any such restrictions.

We may also invest in limited partnership and other ownership interests in entities that own real property. We expect that we may make such investments when we consider it more efficient to acquire an entity owning such real property rather than to acquire the properties directly. We also may acquire less than all of the ownership interests of such entities if we determine that such interests are undervalued and that a liquidation event in respect of such interests are expected within the investment holding periods consistent with that for our direct property investments.

Other than our interest in the Operating Partnership, we currently do not own any securities of other entities. We do not presently intend to acquire securities of any non-affiliated entities.

### *Equity Capital*

If our trustees determine to raise additional equity capital, they have the authority, without shareholder approval, to issue additional common shares or preferred shares of beneficial interests. Additionally, our trustees could cause the Operating Partnership to issue OP Units which are convertible into our common shares. Subject to limitations contained in the organizational and governance documents of the Operating Partnership and us, the trustees could issue, or cause to be issued, such securities in any manner (and on such terms and for such consideration) they deem appropriate, including in exchange for real estate. We have issued securities in exchange for real estate and we expect to continue to do so in the future. Existing shareholders have no preemptive right to purchase such shares in any offering, and any such offering might cause dilution of an existing shareholder's investment in the Company.

### *Environmental Matters*

All real property and the operations conducted on real property are subject to federal, state and local laws and regulations relating to environmental protection and human health and safety. These laws and regulations generally govern wastewater discharges, air emissions, the operation and removal of underground and above-ground storage tanks, the use, storage, treatment, transportation and disposal of solid and hazardous materials, and the remediation of contamination associated with disposals. Under these laws and regulations, a current or previous owner or operator of real property may be liable for the cost of removal or remediation of hazardous or toxic substances on, under or in such property. Some of these laws and regulations may impose joint and several liability

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on tenants, owners or operators for the costs of investigation or remediation of contaminated properties, regardless of fault or the legality of the original disposal and whether or not the owner or operator knew of, or was responsible for, the presence of such hazardous or toxic substances.

Environmental laws also may impose restrictions on the manner in which property may be used or businesses may be operated, and these restrictions may require substantial expenditures. Environmental laws provide for sanctions in the event of noncompliance and may be enforced by governmental agencies or, in certain circumstances, by private parties. Certain environmental laws and common law principles could be used to impose liability for release of and exposure to hazardous substances, including asbestos-containing materials into the air, and third parties may seek recovery from owners or operators of real properties for personal injury or property damage associated with exposure to released hazardous substances. Additionally, concern about indoor exposure to mold has been increasing as exposure to mold may cause a variety of adverse health effects and symptoms, including allergic or other reactions. As a result, the presence of significant mold at any of our properties could require us to undertake a costly remediation program to contain or remove the mold from the affected property, and could expose us to liability from our tenants, their employees and others. The cost of defending against claims of liability, of compliance with environmental regulatory requirements, of remediating any contaminated property, or of paying personal injury claims could materially adversely affect our business, assets or results of operations and, consequently, amounts available for payments of dividends to the Company's shareholders. In addition, the presence of these substances, or the failure to properly remediate these substances, may adversely affect our ability to sell or rent such property or to use the property as collateral for future borrowing.

Some of these laws and regulations have been amended so as to require compliance with new or more stringent standards as of future dates. Compliance with new or more stringent laws or regulations or stricter interpretation of existing laws may require material expenditures by us. We cannot assure you that future laws, ordinances or regulations will not impose any material environmental liability, or that the current environmental condition of our properties will not be affected by the operations of the tenants, by the existing condition of the land, by operations in the vicinity of the properties, such as the presence of underground storage tanks, or by the activities of unrelated third parties. In addition, there are various local, state and federal fire, health, life-safety and similar regulations that we may be required to comply with, and which may subject us to liability in the form of fines or damages for noncompliance.

We will not purchase any property unless and until we obtain what is generally referred to as a "Phase I" environmental site assessment and are generally satisfied with the environmental status of the property. A Phase I environmental site assessment basically consists of a visual survey of the building and the property in an attempt to identify areas of potential environmental concerns, visually observing neighboring properties to assess surface conditions or activities that may have an adverse environmental impact on the property, and contacting local governmental agency personnel and performing a regulatory agency file search in an attempt to determine any known environmental concerns in the immediate vicinity of the property. A Phase I environmental site assessment does not generally include any sampling or testing of soil, groundwater or building materials from the property. Certain properties that we have acquired contain, or contained, dry-cleaning establishments utilizing solvents. Where believed to be warranted, samplings of building materials or subsurface investigations were undertaken with respect to these and other properties. To date, the costs associated with these investigations and any subsequent remedial measures taken have not been material to the Company.

We believe that our properties are in compliance in all material respects with all federal, state and local ordinances and regulations regarding the handling, discharge and emission of hazardous or toxic substances. We have not been notified by any governmental authority, and are not otherwise aware, of any material noncompliance, liability or claim relating to hazardous or toxic substances in connection with any of our present or former properties. We have not recorded in our financial statements any material liability in connection with environmental matters. Nevertheless, it is possible that the environmental assessments available to us do not reveal all potential environmental liabilities. It is also possible that subsequent investigations will identify material contamination, that adverse environmental conditions have arisen subsequent to the performance of the environmental assessments, or that there are material environmental liabilities of which management is unaware.



***Competition***

The Company may experience competition for tenants from owners and managers of similar projects, which may include the Company's affiliates. The Company will experience competition in the acquisition of real estate and the making of mortgages from similar companies with access to greater resources than those available to the Company. At the time the Company elects to dispose of its properties, the Company will also be in competition with sellers of similar properties to locate suitable purchasers for its properties.

***Employees***

Although we have executive officers who have management responsibilities with respect to the Company, we do not have any direct employees. The employees of the Management Company and other affiliates of the Company perform a full range of real estate services for the Company, including acquisitions, property management, accounting, asset management, wholesale brokerage and investor relations. As of December 31, 2004, the Management Company had 81 full time and one part time employees, none of whom was represented by a union.

***Economic Dependency***

The Company is dependent on its affiliates for services that are essential to the Company, including the sale of the Company's shares of common stock, asset acquisition decisions, property management and other general administrative responsibilities. In the event that these companies were unable to provide these services to the Company, the Company would be required to obtain such services from other sources.

***Relationship with the Management Company and Allen R. Hartman***

The Management Company is primarily responsible for managing our day-to-day business affairs and assets and carrying out the directives of our board of trustees. The Management Company is wholly owned by Allen R. Hartman, who is our President and a member of our board of trustees. Mr. Hartman is primarily responsible for the management decisions of the Management Company and its affiliates, including the selection of investment properties to be recommended to our board of trustees, the negotiation for these investments, and the property management and leasing of these investment properties. The Management Company seeks to invest in commercial properties that satisfy our investment objectives, typically retail, industrial and office properties. Our board of trustees, including a majority of our independent trustees, must approve all acquisitions of real estate properties.

Before the commencement of the Company's Public Offering described above, Mr. Hartman received 126,000 of our common shares of beneficial interest for services he provided in connection with our formation and initial capitalization. As of December 31, 2004, we had acquired a total of 34 properties. We acquired 28 of those 34 properties from entities controlled by Mr. Hartman. We acquired these properties by either paying cash, issuing our shares or issuing units of limited partnership interest in the Operating Partnership ("OP Units"). In total, Mr. Hartman received the following as a result of such transactions:

897,117.19 OP Units, as adjusted to reflect the Company's July 2004 reorganization, in consideration of Mr. Hartman's general partner interest in the selling entities;

The ability to limit his future exposure to general partner liability as a result of Mr. Hartman no longer serving as the general partner to certain of the selling entities; and

The repayment of debt encumbering various of our properties which was personally guaranteed by Mr. Hartman.

We owed \$47,386 and \$41,306 in dividends payable to Mr. Hartman on his common shares at December 31, 2004 and December 31, 2003, respectively. Mr. Hartman owned 3.9% and 3.4% of our issued and outstanding common shares as of December 31, 2004 and December 31, 2003, respectively.

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### *Property Management and Advisory Agreements*

In January 1999, we entered into a property management agreement with the Management Company. Effective September 1, 2004, this agreement was amended and restated. Prior to September 1, 2004, in consideration for supervising the management and performing various day-to-day affairs, we paid the Management Company a management fee of 5% and a partnership management fee of 1% based on Effective Gross Revenues from the properties, as defined. After September 1, 2004, we pay the Management Company management fees in an amount not to exceed the fees customarily charged in arm's length transactions by others rendering similar services in the same geographic area, as determined by a survey of brokers and agents in such area. We expect these fees to be between approximately 2% and 4% of Gross Revenues, as such term is defined in the amended and restated property management agreement, for the management of commercial office buildings and approximately 5% of Gross Revenues for the management of retail and industrial properties. Effective September 1, 2004, we entered into an advisory agreement with the Management Company which provides that we pay the Management Company a fee of one-fourth of .25% of Gross Asset Value, as such term is defined in the advisory agreement, per quarter for asset management services. We incurred total management, partnership and asset management fees of \$1,339,822 and \$1,232,127 for the years ended December 31, 2004 and 2003, respectively, of which \$54,331 and \$93,006 were payable at December 31, 2004 and 2003, respectively.

During July 2004, we amended certain terms of its Declaration of Trust. Under the amended terms, the Management Company may be required to reimburse us for operating expenses exceeding certain limitations determined at the end of each fiscal quarter. Expenses did not exceed the limitations in 2004.

Under the provisions of the property management agreements, costs incurred by the Management Company for the management and maintenance of the properties are reimbursable to the Management Company. At December 31, 2004 and 2003, \$188,772 and \$288,305, respectively, was payable to the Management Company related to these reimbursable costs.

In consideration of leasing the properties, we also pay the Management Company leasing commissions of 6% for leases originated by the Management Company and 4% for expansions and renewals of existing leases based on Effective Gross Revenues from the properties. We incurred total leasing commissions to the Management Company of \$952,756 and \$978,398 for the years ended December 31, 2004 and 2003, respectively, of which \$232,343 and \$175,725 were payable at December 31, 2004 and 2003, respectively.

The fees payable to the Management Company under the new agreements effective September 1, 2004 were not significantly different from those that would have been payable under the former agreement.

In connection with the Public Offering, we reimburse the Management Company up to 2.5% of the gross selling price of all common shares sold for organization and offering expenses (excluding selling commissions and a dealer manager fee) incurred by the Management Company on behalf of us. No such reimbursable expenses were incurred for the year ended December 31, 2004 because we had not received the minimum subscription proceeds required to break escrow. As of February 11, 2005, we had incurred reimburseable organization and offering expenses of \$69,444.

Also in connection with the Public Offering, the Management Company receives an acquisition fee equal to 2% of the gross selling price of all common shares sold for services in connection with the selection, purchase, development or construction of properties for us. No such fees were incurred for the year ended December 31, 2004 because we had not received the minimum subscription proceeds required to break escrow. As of February 11, 2005, we had incurred acquisition fees payable to the Management Company of \$55,555.

Pursuant to the requirements of our Declaration of Trust, we have undertaken that, if our shares are not listed for trading on the New York Stock Exchange, the American Stock Exchange, the Nasdaq National Market or another national exchange within twelve years of the termination of the Public Offering, unless such date is extended by the majority vote of both our board of trustees and our independent trustees, we will begin the sale of all of our properties and distribution to our shareholders of the net sale proceeds resulting from our liquidation. The advisory agreement provides for two alternative forms of additional, subordinated incentive compensation to the Management Company related to this contingency, the first of which will take effect if we are required to liquidate our properties and distribute the proceeds, and the second of which will take effect if our common shares become listed on a national securities exchange or the Nasdaq National Market:

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Type of Compensation	Amount of Compensation
Subordinated Participation in Net Sale Proceeds (payable only if our shares are not listed on an exchange and the Company is liquidated)	15.0% of remaining amounts of net sale proceeds after return of investors' capital plus payment to investors of a 7.0% annual, cumulative, noncompounded return on capital. 20.0% of any such Subordinate Participation in Net Sale Proceeds (up to 1.0% of gross proceeds from the Public Offering) will be distributed by the Management Company to the dealer manager, which in turn will redistribute such amount to certain broker-dealers participating in the Public Offering.
Subordinated Incentive Listing Fee (payable only if our shares are listed on an exchange)	15.0% of the amount (if any) by which (i) our adjusted market value plus dividends paid by us prior to listing with respect to the shares sold in the Public Offering exceeds (ii) investors' aggregate capital contributions plus payment to investors of a 7.0% annual, cumulative, noncompounded return on capital. 20.0% of any such Subordinated Incentive Listing Fee (up to 1.0% of gross proceeds from the Public Offering) will be distributed by the Management Company to the dealer manager, which in turn will redistribute such amount to certain broker-dealers participating in the Public Offering.

### *Payments from the Management Company*

The Management Company paid the Company \$106,824, \$106,789 and \$79,168 for office space in 2004, 2003 and 2002, respectively. Such amounts are included in rental income in our consolidated statements of income.

### *Relationship to the Dealer Manager for the Public Offering*

Certain employees of D.H. Hill Securities, the dealer manager for our Public Offering, are also employees of the Management Company. Two of such persons who will have a significant amount of influence on D.H. Hill Securities' day-to-day operations in its capacity as dealer manager for us are Robert W. Engel, our Chief Financial Officer and the Controller of the Management Company, and Richard A. Vaughan, Vice President and Director of Investor Services for the Management Company.

### *Conflicts of Interest*

We are subject to various conflicts of interest arising out of our relationship with the Management Company and its affiliates, including conflicts related to the arrangements described above pursuant to which the Management Company and its affiliates will be compensated by us. Some of the conflicts of interest in our transactions with the Management Company and its affiliates, and the corporate governance measures we adopted to address these conflicts, are described below.

### *Interests in Other Real Estate Programs*

The Management Company and its partners, officers, employees or affiliates are advisors or general partners of other Hartman programs, including partnerships that have investment objectives similar to ours, and we expect that they will organize other such programs in the future. The Management Company and such officers, employees or affiliates have legal and financial obligations with respect to these programs that are similar to their obligations to us.

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Allen R. Hartman and his affiliates have sponsored other privately offered real estate programs with substantially similar investment objectives as ours, and which are still operating and may acquire additional properties in the future. Conflicts of interest may arise between these entities and us.

Mr. Hartman or his affiliates may acquire, for their own account or for private placement, properties that Mr. Hartman deems not suitable for purchase by us, whether because of the greater degree of risk, the complexity of structuring inherent in such transactions, financing considerations or for other reasons, including properties with potential for attractive investment returns.

### *Competition in Acquiring Properties*

Conflicts of interest will exist to the extent that we may acquire properties in the same geographic areas where properties owned by other Hartman programs are located. In such a case, a conflict could arise in the leasing of properties in the event that we and another Hartman program were to compete for the same tenants in negotiating leases, or a conflict could arise in connection with the resale of properties in the event that we and another Hartman program were to attempt to sell similar properties at the same time. Conflicts of interest may also exist at such time as we or our affiliates managing property on our behalf seek to employ developers, contractors or building managers as well as under other circumstances. The Management Company will seek to reduce conflicts relating to the employment of developers, contractors or building managers by making prospective employees aware of all such properties seeking to employ such persons. In addition, the Management Company will seek to reduce conflicts that may arise with respect to properties available for sale or rent by making prospective purchasers or tenants aware of all such properties. However, these conflicts cannot be fully avoided in that there may be established differing compensation arrangements for employees at different properties or differing terms for resales or leasing of the various properties.

### *Affiliated Property Manager*

We anticipate that properties we acquire will be managed and leased by the Management Company as our affiliated property manager, pursuant to the Management Agreement described above. The Management Agreement has a three-year term, which we can terminate only in the event of gross negligence or willful misconduct on the part of the Management Company. We expect the Management Company to also serve as property manager for properties owned by affiliated real estate programs, some of which may be in competition with our properties. As described above, management fees to be paid to the Management Company are based on a percentage of the rental income received by the managed properties.

### *Joint Ventures with Affiliates of the Management Company*

We may determine to enter into joint ventures with other Hartman programs (as well as other parties) for the acquisition, development or improvement of properties. The Management Company and its affiliates may have conflicts of interest in determining which Hartman program should enter into any particular joint venture agreement. The co-venturer may have economic or business interests or goals which are or which may become inconsistent with our business interests or goals. In addition, should any such joint venture be consummated, the Management Company may face a conflict in structuring the terms of the relationship between our interests and the interest of the co-venturer and in managing the joint venture. Since the Management Company and its affiliates will control both us and any affiliated co-venturer, agreements and transactions between the co-venturers with respect to any such joint venture will not have the benefit of arm's-length negotiation of the type normally conducted between unrelated co-venturers.

### *Receipt of Fees and Other Compensation by the Management Company and its Affiliates*

A transaction involving the purchase and sale of properties may result in the receipt of commissions, fees and other compensation by the Management Company and its affiliates, including acquisition fees, the dealer manager fee, property management and leasing fees, real estate brokerage commissions, and participation in nonliquidating net sale proceeds. However, the fees and compensation payable to the Management Company and its affiliates relating to the sale of properties are only payable after the return to the shareholders of their capital contributions plus cumulative returns on such capital. Subject to oversight by our board of trustees, the Management Company has considerable discretion with respect to all decisions relating to the terms and timing of

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all transactions. Therefore, the Management Company may have conflicts of interest concerning certain actions taken on our behalf, particularly due to the fact that such fees will generally be payable to the Management Company and its affiliates regardless of the quality of the properties acquired or the services provided to us.

### *No Arm's-Length Agreements*

All agreements, contracts or arrangements between or among Mr. Hartman and his affiliates, including the Management Company, and us were not negotiated at arm's-length. Such agreements include the Management Agreement, our Declaration of Trust, the Operating Partnership's partnership agreement, and various agreements involved in our acquisition of properties acquired from Mr. Hartman or his affiliates. The policies with respect to conflicts of interest described herein were designed to lessen the potential conflicts that arise from such relationships. As described below, all conflict of interest transactions must also be approved by the conflicts committee of our board of trustees in the future.

### *Additional Conflicts of Interest*

We will potentially be in conflict of interest positions with Mr. Hartman and the Management Company as to various other matters in our day-to-day operations, including matters related to the:

computation of fees and/or reimbursements under the Operating Partnership's partnership agreement and the Management Agreement;

enforcement of the Management Agreement;

termination of the Management Agreement;

order and priority in which we pay the obligations of the Operating Partnership, including amounts guaranteed by or due to Mr. Hartman or his affiliates;

order and priority in which we pay amounts owed to third parties as opposed to amounts owed to the Management Company;

timing, amount and manner in which we refinance any indebtedness; and

extent to which we repay or refinance the indebtedness which is recourse to Mr. Hartman prior to nonrecourse indebtedness and the terms of any such refinancing.

### *Certain Conflict Resolution Procedures*

#### *Conflicts Committee*

In order to reduce or eliminate certain potential conflicts of interest, we have created a conflicts committee of our board of trustees comprised of all of our independent trustees. Serving on the board or, or owning an interest in, the Company will not, by itself, preclude a trustee from serving on the conflicts committee. The conflicts committee is empowered to act on any matter permitted under Maryland law, provided that it first determine that the matter at issue is such that the exercise of independent judgment by affiliates of the Management Company could reasonably be compromised. Those conflict of interest matters that we cannot delegate to a committee under Maryland law must be acted upon by both the board of trustees and the conflicts committee. Among the matters we expect the conflicts committee to act upon are:

the continuation, renewal or enforcement of our agreements with the Management Company and its affiliates, including the Advisory Agreement and the dealer manager agreement;

public offerings of securities;

property sales;

property acquisitions;

transactions with affiliates;

compensation of our officers and trustees who are affiliated with our advisors;

whether and when we seek to list our common shares on the New York Stock Exchange, the American Stock Exchange, the Nasdaq National Market or another national exchange; and

whether and when we seek to sell the company or its assets.

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### *Other Declaration of Trust Provisions Relating to Conflicts of Interest*

In addition to the creation of the conflicts committee, our Declaration of Trust contains many other restrictions relating to (1) transactions we enter into with the Management Company and its affiliates, (2) certain future offerings, and (3) allocation of investment opportunities among affiliated entities. These restrictions include, among others, the following:

We will not purchase or lease properties in which the Management Company, any of our trustees or any of their respective affiliates has an interest without a determination by a majority of the trustees, including a majority of the independent trustees, not otherwise interested in such transaction, that such transaction is fair and reasonable to us and at a price to us no greater than the cost of the property to the seller or lessor unless there is substantial justification for any amount that exceeds such cost and such excess amount is determined to be reasonable. In no event will we acquire any such property at an amount in excess of its appraised value. We will not sell or lease properties to the Management Company, any of our trustees or any of their respective affiliates unless a majority of the trustees, including a majority of the independent trustees, not otherwise interested in the transaction, determines the transaction is fair and reasonable to us.

We will not make any loans to the Management Company, any of our trustees or any of their respective affiliates, except that we may make or invest in mortgage loans involving the Management Company, our trustees or their respective affiliates, provided that an appraisal of the underlying property is obtained from an independent appraiser and the transaction is approved as fair and reasonable to us and on terms no less favorable to us than those available from third parties. In addition, the Management Company, any of our trustees and any of their respective affiliates will not make loans to us or to joint ventures in which we are a joint venture partner unless approved by a majority of the trustees, including a majority of the independent trustees, not otherwise interested in the transaction as fair, competitive and commercially reasonable, and no less favorable to us than comparable loans between unaffiliated parties.

The Management Company and its affiliates shall be entitled to reimbursement, at cost, for actual expenses incurred by them on behalf of us or joint ventures in which we are a joint venture partner, subject to the limitation that for any year in which we qualify as a REIT, the Management Company must reimburse us for the amount, if any, by which our total operating expenses, including the asset management fee, paid during the previous fiscal year exceeds the greater of: (i) 2.0% of our average invested assets for that fiscal year, or (ii) 25.0% of our net income, before any additions to reserves for depreciation, bad debts or other similar non-cash reserves and before any gain from the sale of our assets, for that fiscal year.

In the event that an investment opportunity becomes available that is suitable, under all of the factors considered by the Management Company, for both us and one or more other entities affiliated with the Management Company and its affiliates, and for which more than one of such entities has sufficient uninvested funds, then the entity that has had the longest period of time elapse since it was offered an investment opportunity will first be offered such investment opportunity. It shall be the duty of our board of trustees, including the independent trustees, to insure that this method is applied fairly to us. In determining whether or not an investment opportunity is suitable for more than one program, the Management Company, subject to approval by our board of trustees, shall examine, among others, the following factors:

the anticipated cash flow of the property to be acquired and the cash requirements of each program;

the effect of the acquisition both on diversification of each program's investments by type of property and geographic area and on diversification of the tenants of its properties;

the policy of each program relating to leverage of properties;

the income tax effects of the purchase to each program;

the size of the investment; and

the amount of funds available to each program and the length of time such funds have been available for investment.

If a subsequent development, such as a delay in the closing of a property or a delay in the construction of a property, causes any such investment, in the opinion of our board of trustees and the Management Company, to be more appropriate for a program other than the program that committed to make the investment, the Management Company may determine that another program affiliated with the Management Company or its affiliates will make the investment. Our board of trustees has a duty to ensure that the method used by the Management Company for the allocation of the acquisition of properties by two or more affiliated programs seeking to acquire similar types of properties is applied fairly to us.

We will not accept goods or services from the Management Company or its affiliates or enter into any other transaction with the Management Company or its affiliates unless a majority of our trustees, including a majority of the independent trustees, not otherwise interested in the transaction approve such transaction as fair and reasonable to us and on terms and conditions not less favorable to us than those available from unaffiliated third parties.



*Financial Information About Segments*

See Note 14 to the consolidated financial statements for information about our reportable segments.

*Web Site Address*

The Company electronically files its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports with the Securities and Exchange Commission ("SEC"). Copies of the Company's filings with the SEC may be obtained from the Company's website at [www.hartmanmgmt.com](http://www.hartmanmgmt.com) or at the SEC's website, at <http://www.sec.gov>. Access to these filings is free of charge. The Company's code of ethics and certain other corporate governance documentation may also be obtained from the Company's website at [www.hartmanmgmt.com](http://www.hartmanmgmt.com). The information on our web site is not, and should not be considered to be, a part of this report.

**Item 2. Description of Real Estate and Operating Data.**

On December 31, 2004, the Company owned the 34 properties discussed below. All of the Company's properties are located in the metropolitan Houston, Texas and San Antonio, Texas areas. The Company's properties primarily consist of retail centers and each is designed to meet the needs of surrounding local communities. A supermarket or one or more nationally and/or regionally recognized tenants typically anchors each of the Company's properties. In the aggregate, the Company's properties contain approximately 2,635,000 square feet of gross leasable area. No individual property in the Company's portfolio currently accounts for more than 10% of the Company's aggregate leasable area.

As of December 31, 2004, the Company's properties were approximately 86.2% leased. Anchor space at the properties, representing approximately 10.0% of total leasable area, was 91.4% leased, while non-anchor space, accounting for the remaining 90.0% balance, was approximately 85.6% leased. A substantial number of the Company's tenants are local tenants. Indeed, 74.5% of the Company's tenants are local tenants and 12.2% and 13.3% of the Company's tenants are national and regional tenants, respectively. The Company defines:

national tenants as any tenant that operates in at least four metropolitan areas located in more than one region (i.e. Northwest, Midwest, Southwest or Southeast);

regional tenants as any tenant that operates in two or more metropolitan areas located within the same region; and

local tenants as any tenant that operates stores only within the metropolitan Houston, Texas or San Antonio, Texas area.

Substantially all of the Company's revenues consist of base rents and percentage rents received under long-term leases. For the year ended December 31, 2004, total rents and other income were \$23,106,301 and percentage rents were \$-0-. Approximately 66.5% of all existing leases provide for annual increases in the base rental payments with a "step up" rental clause.

The following table lists the five properties that generated the most rents during the year 2004.

Property	Total Rents Received in 2004	Percent of Company's Total Rents Received in 2004
Windsor Park	\$ 2,210,247	9.57%
Corporate Park West	1,700,224	7.36
Corporate Park Northwest	1,547,294	6.70
Lion Square	1,256,219	5.44
Plaza Park	1,016,687	4.40
<b>Total</b>	<b>\$ 7,730,671</b>	<b>33.47%</b>

The Company currently does not have any individual properties that are material to its operations. As of December 31, 2004, the Company had no property that accounted for over 10% of either the Company's total assets or total gross revenue.

The next several pages contain summary information for the properties the Company owned on December 31, 2004.

***General Physical Attributes***

The following table lists, for all properties the Company owned on December 31, 2004, the year each property was developed or significantly renovated, the total leasable area of each property, the purchase price the Company paid for such property and the anchor or largest tenant at such property.

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Property	Year Developed/ Renovated	Total Leasable Area (Sq. Ft.)	Purchase Price	Anchor or Largest Tenant
Bissonnet/Beltway	1978	29,205	\$ 2,361,323	Cash America International
Webster Point	1984	26,060	1,870,365	Houston Learning Academy
Centre South	1974	44,593	2,077,198	Carlos Alvarez
Torrey Square	1983	105,766	4,952,317	99 Cents Only Stores
Providence	1980	90,327	4,592,668	99 Cents Only Stores
Holly Knight	1984	20,015	1,612,801	Quick Wash Laundry
Plaza Park	1982	105,530	4,195,116	American Medical Response
Northwest Place II	1984	27,974	1,089,344	Terra Mar, Inc.
Lion Square	1980	119,621	5,835,108	Kroger Food Stores, Inc.
Zeta Building	1982	37,740	2,456,589	American Title Co.
Royal Crest	1984	24,900	1,864,065	Paragon Benefits, Inc.
Featherwood	1983	49,670	2,959,309	Transwestern Publishing
Interstate 10	1980	151,000	3,908,072	River Oaks, L-M, Inc.
Westbelt Plaza	1978	65,619	2,733,009	National Oilwell
Greens Road	1979	20,507	1,637,217	Juan Gailegos
Town Park	1978	43,526	3,760,735	Omar's Meat Market
Northeast Square	1984	40,525	2,572,512	99 Cent Store
Main Park	1982	113,410	4,048,837	Transport Sales
Dairy Ashford	1981	42,902	1,437,020	Foster Wheeler USA Corp.
South Richey	1980	69,928	3,361,887	Kroger Food Stores, Inc.
Corporate Park Woodland	2000	99,937	6,028,362	Carrier Sales and Distribution
South Shaver	1978	21,926	817,003	EZ Pawn
Kempwood Plaza	1974	112,359	2,531,876	Auto Zone
Bellnot Square	1982	73,930	5,792,294	Kroger Food Stores, Inc.
Corporate Park Northwest	1981	185,627	7,839,539	Air Consulting & Engineering
Westgate	1984	97,225	3,448,182	Postmark DMS, LLC
Garden Oaks	1954	95,046	6,577,782	Bally Total Fitness
Westchase	1978	42,924	2,173,300	Jesus Corral
Sunridge	1979	49,359	1,461,571	Puro Latino, Inc.
Holly Hall	1980	90,000	3,123,400	The Methodist Hospital
Brookhill	1979	74,757	973,264	T.S. Moly-Lubricants
Corporate Park West	1999	175,665	13,062,980	Accurate Restoration, Inc.
Windsor Park	1992	192,458	13,102,500	The Sports Authority
Stafford Plaza	1974	95,032	8,906,057	Marshall's
<b>Total</b>		<b>2,635,063</b>	<b>\$ 135,163,602</b>	

*General Economic Attributes*

The following table lists certain information that relates to the rents generated by each property. All of the information listed in this table is as of December 31, 2004.

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Property	Percent Leased	Total Leasable Area (Sq. Ft.)	Total Annualized Rents Based on Occupancy	Effective Net Rent Per Sq. Ft.	Annual Percentage Rents
Bissonnet/Beltway	100.0%	29,205	\$ 513,012	\$ 17.57	
Webster Point	87.0	26,060	354,396	13.60	
Centre South	83.6	44,593	423,721	9.50	
Torrey Square	85.8	105,766	954,518	9.02	
Providence	68.8	90,327	671,926	7.44	
Holly Knight	93.2	20,015	349,373	17.46	
Plaza Park	92.1	105,530	995,169	9.43	
Northwest Place II	61.7	27,974	140,440	5.02	
Lion Square	100.0	119,621	1,248,321	10.44	
Zeta Building	80.0	37,740	443,361	11.75	
Royal Crest	100.0	24,900	328,037	13.17	
Featherwood	87.8	49,670	840,519	16.92	
Interstate 10	74.5	151,000	616,310	4.08	
Westbelt Plaza	91.3	65,619	609,543	9.29	
Greens Road	100.0	20,507	386,759	18.86	
Town Park	100.0	43,526	804,971	18.49	
Northeast Square	84.1	40,525	473,940	11.69	
Main Park	87.2	113,410	647,073	5.71	
Dairy Ashford	51.1	42,902	165,824	3.87	
South Richey	74.3	69,928	443,745	6.35	
Corporate Park Woodland	85.7	99,937	868,655	8.69	
South Shaver	75.7	21,926	230,954	10.53	
Kempwood Plaza	74.5	112,359	863,884	7.69	
Bellnot Square	100.0	73,930	788,159	10.66	
Corporate Park Northwest	83.7	185,627	1,546,646	8.33	
Westgate	82.7	97,225	604,690	6.22	
Garden Oaks	78.6	95,046	980,002	10.31	
Westchase	91.8	42,924	454,396	10.59	
Sunridge	89.6	49,359	462,296	9.37	
Holly Hall	100.0	90,000	533,774	5.93	
Brookhill	69.9	74,757	264,060	3.53	
Corporate Park West	86.3	175,665	1,587,748	9.04	
Windsor Park	100.0	192,458	1,863,375	9.68	
Stafford Plaza	98.6	95,032	1,072,105	11.28	
<b>Total/Average</b>	<b>86.2%</b>	<b>2,635,063</b>	<b>\$ 23,531,702</b>	<b>\$ 8.93</b>	

The following table lists, for each property, as of December 31 of each of the last five years or for as long as the Company has owned the property, both the occupancy of each property and the average rental and other income per square foot of gross leasable area.

Property	2000		2001		2002		2003		2004	
	Percent Leased	Average Income Per Sq. Ft.	Percent Leased	Average Income Per Sq. Ft.	Percent Leased	Average Income Per Sq. Ft.	Percent Leased	Average Income Per Sq. Ft.	Percent Leased	Average Income Per Sq. Ft.
Bissonnet/Beltway	100%	\$ 14.42	100%	\$ 17.02	93%	\$ 16.50	100%	\$ 16.97	100%	\$ 15.54
Webster Point	86	10.92	93	10.57	83	11.83	88	12.05	87	12.99
Centre South	71	6.31	88	7.96	88	7.40	85	8.03	87	9.19
Torrey Square	96	7.69	99	9.71	96	9.82	87	8.09	86	8.02
Providence			100	8.81	98	12.71	72	11.19	69	6.51
Holly Knight	93	14.02	100	17.58	91	16.46	96	17.50	93	16.39
Plaza Park	85	6.26	83	7.60	93	7.89	79	8.26	92	9.63
Northwest Place II	80	5.76	52	5.31	52	4.40	62	4.96	62	4.61
Lion Square	97	8.84	100	9.59	98	9.91	98	9.68	100	10.50
Zeta Building	86	13.43	91	13.84	94	14.21	98	12.46	80	12.99
Royal Crest	73	10.34	73	7.38	88	10.24	95	11.43	100	12.34
Featherwood	77	2.01	96	12.86	96	15.46	98	16.07	89	17.37
Interstate 10	82	3.97	97	4.36	96	4.78	83	4.84	74	4.09
Westbelt Plaza	93	6.92	85	7.21	92	8.88	82	8.26	91	8.68
Greens Road	78	15.83	100	16.54	100	18.60	100	16.15	100	17.02

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	2000		2001		2002		2003		2004	
Town Park	100	16.09	100	19.01	100	17.88	98	18.12	100	18.08
Northeast Square	81	9.91	84	9.14	90	11.81	81	12.48	84	11.80
Main Park	81	5.41	89	4.89	87	5.53	90	5.57	87	5.57
Dairy Ashford	80	5.94	100	6.11	100	5.83	55	3.41	51	3.99
South Richey	100	8.72	94	9.45	100	9.63	94	8.57	74	7.77
Corporate Park										
Woodland	4	0.06	19	1.75	76	4.70	97	7.76	86	8.67
South Shaver	57	5.11	83	7.29	97	9.82	89	11.06	76	11.75
Kempwood Plaza	95	5.79	91	5.72	93	6.73	95	7.88	74	7.64
Bellnot Square	96	10.70	98	11.71	98	11.53	96	11.82	100	11.60
Corporate Park										
Northwest	92	7.38	91	8.28	90	8.74	90	8.33	84	8.34
Westgate	83	4.26	96	5.54	96	6.78	85	6.88	83	6.53
Garden Oaks	86	9.44	82	10.32	86	10.69	78	10.34	79	10.38
Westchase	50	2.51	75	7.16	66	8.15	77	8.94	92	8.83
Sunridge	71	4.33	77	9.39	96	10.71	90	10.93	90	9.56
Holly Hall	91	4.56	100	5.12	100	4.63	100	5.45	90	5.89
Brookhill	52	1.59	75	3.43	89	3.45	59	3.39	70	3.51
Corporate Park West	71	3.88	92	8.47	95	9.79	94	9.13	86	9.68
Windsor Park									100	11.48
Stafford Plaza									99	12.24

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*Major Tenants*

The following table sets forth certain information that relates to the major tenants at each property. This information is as of December 31, 2004. The information summarizes information relating to each anchor or largest tenant at each property. No single lease accounted for more than 5% of the Company's total revenues during 2003.

<b>Property</b>	<b>Name of Tenant</b>	<b>Total Leased Area (Sq. Ft.)</b>	<b>Total Annual Rent</b>	<b>Effective Net Rent per Sq. Ft.</b>	<b>Lease Expiration Date</b>
Bissonnet/Beltway	Cash America International	5,300	\$ 84,444	\$ 15.93	4/30/05
Webster Point	Houston Learning Academy	3,976	64,737	16.28	12/31/06
Centre South	Carlos Alvarez	10,407	96,091	9.23	3/31/06
Torrey Square	99 Cents Only Stores	25,296	219,100	8.66	9/18/04
Providence	99 Cents Only Stores	23,859	225,567	9.45	9/9/08
Holly Knight	Quick Wash Laundry	2,460	50,373	20.48	9/30/09
Plaza Park	American Medical Response	14,765	136,299	9.23	5/31/06
Northwest Place II	Terra Mar, Inc.	13,923	112,743	8.10	7/31/08
Lion Square	Kroger Food Stores, Inc.	42,205	253,440	6.00	10/31/05
Zeta Building	American Title Co.	3,233	54,314	16.80	2/28/05
Royal Crest	Paragon Benefits, Inc.	2,500	33,596	13.44	2/28/07
Featherwood	Transwestern Publishing	9,543	167,774	17.58	11/30/07
Interstate 10	River Oaks, L-M, Inc.	28,050	159,885	5.70	12/31/05
Westbelt Plaza	National Oilwell	13,300	176,652	13.28	3/31/05
Greens Road	Juan Gailegos	3,985	28,965	7.27	12/31/11
Town Park	Omar's Meat Market	6,450	121,680	18.87	12/31/07
Northeast Square	99 Cent Store	4,573	52,220	11.42	11/30/05
Main Park	Transport Sales	23,882	103,143	4.32	8/31/05
Dairy Ashford	Foster Wheeler USA Corp.	5,118	34,760	6.79	1/31/09
South Richey	Kroger Food Stores, Inc.	42,130	265,416	6.30	2/28/06
Corporate Park Woodland	Carrier Sales and Distribution	16,991	164,204	9.66	7/31/08
South Shaver	EZ Pawn	4,547	61,133	13.44	11/30/07
Kempwood Plaza	Auto Zone	7,960	84,931	10.67	10/31/14
Bellnot Square	Kroger Food Stores, Inc.	42,130	337,044	8.00	7/31/07
Corporate Park Northwest	Air Consulting & Engineering	11,226	115,472	10.29	5/31/08
Westgate	Postmark DMS, LLC	18,818	139,175	7.40	2/28/09
Garden Oaks	Bally Total Fitness	25,722	259,166	10.08	6/30/05
Westchase	Jesus Corral	5,396	60,271	11.17	2/28/07
Sunridge	Puro Latino, Inc.	9,416	53,381	5.67	5/31/10
Holly Hall	The Methodist Hospital	30,000	183,960	6.13	12/31/11
Brookhill	T.S. Moly-Lubricants	10,187	48,897	4.80	9/30/07
Corporate Park West	Accurate Restoration, Inc.	18,330	151,003	8.24	7/31/06
Windsor Park	The Sports Authority	54,517	463,472	8.50	8/31/15
Stafford Plaza	Marshall's	31,008	280,956	9.06	1/31/08

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*Lease Expirations*

The following table lists, on an aggregate basis, all of the scheduled lease expirations over the next 10 years.

Year	Gross Leasable Area			Annual Rental Income	
	Number of Leases	Approximate Square Feet	Percent of Total Leasable Area	Amount	Percent of the Company's Total Rental Income
2005	144	519,470	19.71%	\$ 5,006,293	21.27%
2006	121	404,615	15.36	3,989,468	16.95
2007	127	402,539	15.28	4,149,674	17.63
2008	82	335,589	12.74	3,603,222	15.31
2009	83	244,549	9.28	2,719,524	11.56
2010	33	131,586	4.99	1,452,767	6.17
2011	15	68,273	2.59	798,986	3.40
2012	8	28,835	1.09	392,686	1.67
2013	6	41,045	1.56	474,432	2.02
2014	8	23,868	.91	313,107	1.33
<b>Total</b>	<b>627</b>	<b>2,200,369</b>	<b>83.50%</b>	<b>\$ 22,900,159</b>	<b>97.31%</b>

*Depreciation and Tax Items*

Depreciation on the Company's properties are taken on a straight line basis over 5 to 39 years for book purposes, resulting in a rate of approximately 2.5% per year. The following table shows certain tax items relating to the Company's properties.

Property	Federal Tax Basis	Realty Tax Rate	2004 Realty Taxes
Bissonnet/Beltway	\$ 1,987,210	0.0298627	\$ 39,717
Webster Point	1,380,961	0.0265927	23,154
Centre South	1,737,670	0.0321040	42,056
Torrey Square	3,607,250	0.0352077	116,185
Providence	4,830,878	0.0330224	118,881
Holly Knight	1,747,039	0.0299125	32,305
Plaza Park	2,099,578	0.0299125	85,251
Northwest Place II	967,581	0.0320077	23,430
Lion Square	4,798,488	0.0298627	141,600
Zeta Building	2,366,569	0.0333127	46,638
Royal Crest	1,941,318	0.0333127	23,319
Featherwood	3,369,216	0.0321040	88,896
Interstate 10	2,855,240	0.0310627	80,142
Westbelt Plaza	1,834,055	0.0310627	59,019
Greens Road	877,843	0.0326328	43,989
Town Park	1,392,577	0.0298627	61,935
Northeast Square	1,681,073	0.0287500	55,229
Main Park	2,756,429	0.0299125	80,764
Dairy Ashford	834,072	0.0299125	28,014
South Richey	3,481,667	0.0321040	96,312
Corporate Park Woodlands	6,504,928	0.0302800	152,499
South Shaver	921,353	0.0312740	33,219
Kempwood Plaza	3,274,773	0.0310627	87,317
Bellnot Square	4,364,091	0.0298627	112,675
Corporate Park Northwest	4,947,247	0.0320077	176,042
Westgate	1,861,804	0.0331627	69,642
Garden Oaks	4,582,312	0.0299125	126,299
Westchase	1,643,016	0.0307627	60,742

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Property	Federal Tax Basis	Realty Tax Rate	2004 Realty Taxes
Sunridge	2,307,528	0.0307627	69,249
Holly Hall	1,815,336	0.0299125	62,827
Brookhill	1,258,673	0.0299125	34,839
Corporate Park West	9,438,227	0.0331627	248,720
Windsor Park	13,102,500	0.0282601	308,733
Stafford Plaza	8,906,057	0.0298627	198,885

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***Insurance***

The Company believes that it has property and liability insurance with reputable, commercially rated companies. The Company also believes that its insurance policies contain commercially reasonable deductibles and limits, adequate to cover its properties. The Company expects to maintain such insurance coverage and to obtain similar coverage with respect to any additional properties the Company acquires in the near future. Further, the Company has title insurance relating to its properties in an aggregate amount that the Company believes to be adequate.

***Regulations***

The Company's properties, as well as any other properties that the Company may acquire in the future, are subject to various federal, state and local laws, ordinances and regulations, including, among other things, zoning regulations, land use controls, environmental controls relating to air and water quality, noise pollution and indirect environmental impacts such as increased motor vehicle activity. The Company believes that it has all permits and approvals necessary under current law to operate its properties.

**Item 3. Legal Proceedings.**

The nature of the Company's business exposes it to the risk of lawsuits for damages or penalties relating to, among other things, breach of contract and employment disputes. The Company is not currently a party to any pending material litigation.

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

None

**PART II**

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

***Market Information***

There is no established trading market for the Company's common stock. Therefore, there is a risk that a shareholder may not be able to sell the Company's common stock at a time or price acceptable to the shareholder, and investors should purchase the Company's shares only as a long-term investment.

For these reasons, an investment in the Company involves significant risk and is only suitable for persons who have adequate financial means, desire a relatively long-term investment and who will not need immediate liquidity from their investment. In consideration of these factors, we have established suitability standards for investors in the Public Offering, as well as for subsequent purchasers of our shares. These suitability standards require that a purchaser of shares have either:

a net worth of at least \$150,000; or

a gross annual income of at least \$45,000 and a net worth of at least \$45,000.

For purposes of determining suitability of an investor, net worth in all cases should be calculated excluding the value of an investor's home, furnishings and automobiles. In the case of sales to fiduciary accounts, these suitability standards must be met by the fiduciary account, by the person who directly or indirectly supplied the funds for the purchase of the shares if such person is the fiduciary or by the beneficiary of the account.

The suitability standards described above also apply to potential subsequent purchasers of our shares. Accordingly, even if a shareholder is able to find a subsequent buyer for his or her shares in the Company, the shares may not be sold to such buyer unless the buyer meets the suitability standards applicable to him or her, including any suitability standards imposed by such potential purchaser's state of residence. Our Declaration of Trust also imposes certain restrictions on the ownership of common shares that will apply to potential transferees that may inhibit your ability to sell your shares. Moreover, except for requests for redemptions by the estate, heir or beneficiary of a deceased shareholder, our board of trustees may reject any request for redemption of shares or amend, suspend or terminate our share redemption program at any time. Therefore, it will be difficult for holders of the Company's common shares to sell their shares promptly or at all. In particular, shareholders may not be able to sell their shares in the event of an emergency, and, if they are able to sell such shares, may have to sell them at a substantial discount. It is also likely that our shares would not be accepted as the primary collateral for a loan to any of our shareholders.

Unless and until the Company or the Maryland REIT causes its shares to be listed on a national securities exchange or includes the shares for quotation on the Nasdaq Stock Market, it is not expected that a public market for the shares will develop. To assist fiduciaries of tax-qualified pension, stock bonus or profit-sharing plans, employee benefit plans and annuities described in Section 403(a) or (b) of the Internal Revenue Code or an individual retirement account or annuity described in Section 408 of the Internal Revenue Code, subject to the annual reporting requirements of ERISA and IRA trustees or custodians in preparation of reports relating to an investment in the shares, the Company intends to provide reports of the quarterly and annual determinations of the current value of the net assets per outstanding share to those fiduciaries who request such reports.

***Public Offering Proceeds***

The Company's Registration Statement on Form S-11 (SEC File No. 333-111674) was declared effective by the SEC on September 15, 2004 with respect to the Public Offering described in Item 1 above of up to 10,000,000 shares of the Company's common stock to the public at a price of \$10 per share, plus up to 1,000,000 shares available for sale pursuant to our dividend reinvestment plan, to be offered at a price of \$9.50 per share, and the Company commenced the Public Offering on such date.

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The 10,000,000 shares offered to the public in the Public Offering are being offered to investors on a best efforts basis, which means that the broker-dealers participating in the offering are only required to use their best efforts to sell the shares and have no firm commitment or obligation to purchase any of the shares.

As of December 31, 2004, no shares had been issued pursuant to the Public Offering, because its terms provided that the Company would not admit new shareholders pursuant to the Public Offering, or receive any proceeds therefrom, until subscriptions aggregating at least \$2,000,000 (200,000 shares) were received and accepted by the Company, not including shares sold to residents of either New York or Pennsylvania. As of December 31, 2004, the Company had received and accepted subscriptions for a total of 147,432 shares for gross offering proceeds of \$1,474,320 held in escrow as of such date.

As of February 11, 2005, the Company had accepted subscriptions for 277,775 shares (not including shares sold to residents of either New York or Pennsylvania) and, accordingly, 277,775 shares had been issued pursuant to the Public Offering as of such date with gross offering proceeds received of \$2,777,750. The Company's application of such gross offering proceeds has been as follows:

<b>Description of Use of Offering Proceeds</b>	<b>Amount of Proceeds so Utilized</b>
Selling Commissions paid to broker/ dealers not affiliated with D.H. Hill Securities, LLP	\$ 148,816
Dealer Manager Fee paid to D.H. Hill Securities, LLP	\$ 69,444
Offering expense reimbursements paid to the Management Company	\$ 69,444
Acquisition Fees paid to the Management Company	\$ 55,555
Used for Working Capital	\$ 1,661,375
Amounts temporarily invested in money market accounts pending final application of proceeds by the Company	\$ 773,116

### ***Issuer Repurchases***

The Company did not repurchase any of its equity securities during the fourth quarter of the period covered by this Annual Report on Form 10-K.

### ***Holdings***

As of March 22, 2005, the Company had 7,443,420 shares of common stock outstanding held by a total of approximately 742 shareholders.

### ***Dividends***

In order to remain qualified as a REIT, the Company is required to distribute at least 90% of its annual taxable income to the Company's shareholders. The Company currently accrues dividends quarterly and pays such dividends in three monthly installments following the end of the quarter and intends to continue doing so.

The following table shows the dividends the Company has paid (including the total amount paid and the amount paid on a per share basis) since the Company commenced operations. The amounts provided in the table give effect to our reorganization as a Maryland real estate investment trust and the concurrent recapitalization of our common shares on July 28, 2004.

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Month Paid	Total Amount of Dividends Paid	Dividends Per Share
November 1999	\$ 59,365	\$ 0.1610
February 2000	109,294	0.1628
May 2000	320,276	0.1645
August 2000	402,124	0.1663
November 2000	478,206	0.1680
February 2001	559,440	0.1698
May 2001	541,380	0.1400
August 2001	602,138	0.1400
November 2001	635,778	0.1400
February 2002	687,544	0.1488
May 2002	1,102,340	0.1575
August 2002	1,166,709	0.1663
November 2002	1,226,777	0.1750
February 2003	1,226,777	0.1750
April 2003	408,762	0.0583
May 2003	408,762	0.0583
June 2003	409,253	0.0584
July 2003	408,762	0.0583
August 2003	408,762	0.0583
September 2003	409,253	0.0584
October 2003	408,762	0.0583
November 2003	408,762	0.0583
December 2003	409,253	0.0584
January 2004	408,762	0.0583
February 2004	408,762	0.0583
March 2004	409,253	0.0584
April 2004	408,762	0.0583
May 2004	408,762	0.0583
June 2004	409,253	0.0584
July 2004	408,762	0.0583
August 2004	408,762	0.0583
September 2004	409,253	0.0584
October 2004	408,692	0.0583
November 2004	408,692	0.0583
December 2004	409,392	0.0584
January 2005	408,692	0.0583
February 2005	408,692	0.0583
March 2005	412,897	0.0589
Average Per Quarter		\$ 0.1652

*Recent Sales of Unregistered Securities*

None.

**Item 6. Selected Financial Data.**

The following table sets forth selected consolidated financial information for the Company and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's audited consolidated financial statements and the notes thereto, both of which appear elsewhere in this annual report.

	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(in thousands, except per share data)				
<b>Income Statement Data:</b>					
Revenues	\$ 23,484	\$ 20,973	\$ 20,755	\$ 11,704	\$ 9,626
Operations expenses	9,183	8,383	8,242	5,068	3,925
Interest	2,664	1,323	1,573	812	1,271
Depreciation and amortization	5,223	4,758	4,042	2,151	1,786
Total expenses	17,070	14,464	13,857	8,031	6,982
Income before minority interests	6,414	6,509	6,898	3,673	2,644
Minority interest in income	(2,990)	(3,035)	(3,193)	(1,932)	(1,770)
Net income	\$ 3,424	\$ 3,474	\$ 3,705	\$ 1,741	\$ 874
Net income per common share	\$ 0.488	\$ 0.496	\$ 0.529	\$ 0.401	\$ 0.332
Weighted average shares outstanding	7,010	7,010	7,007	4,336	2,630
<b>Balance Sheet Data:</b>					
Real estate	\$ 126,547	\$ 120,256	\$ 109,294	\$ 66,269	\$ 62,781
Other assets	16,070	13,810	17,670	4,409	3,017
Total assets	\$ 142,617	\$ 134,066	\$ 126,964	\$ 70,678	\$ 65,798
Liabilities	\$ 66,299	\$ 55,183	\$ 45,617	\$ 16,311	\$ 17,439
Minority interests in Operating Partnership	36,489	37,567	38,598	27,264	27,278
Shareholders' equity	39,829	41,316	42,749	27,103	21,081
	\$ 142,617	\$ 134,066	\$ 126,964	\$ 70,678	\$ 65,798
<b>Cash Flow Data:</b>					
Proceeds from issuance of common shares	\$	\$	\$ 155	\$ 6,748	\$ 11,660
Additions to real estate	10,277	8,242	1,983	5,028	6,089
<b>Other Financial Data:</b>					
Distributions per share	\$ 0.7005	\$ 0.7000	\$ 0.6738	\$ 0.5688	\$ 0.6685

The distributions per share represent payments from cash flow rather than from the Company's net income.

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

You should read the following discussion of our financial condition and results of operations in conjunction with our audited consolidated financial statements and the notes thereto included in this annual report. For more detailed information regarding the basis of presentation for the following information, you should read the notes to the audited consolidated financial statements included in this annual report.

*Overview*

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We own 34 commercial properties, consisting of 19 retail centers, 12 office/warehouse properties and three office buildings. All of our properties are located in the Houston, Texas and San Antonio, Texas metropolitan areas. As of December 31, 2004, we had 632 total tenants. No individual lease or tenant is material to our business. Revenues from our largest lease constituted 2.27% of our total revenues for the year ended December 31, 2004. Leases for our properties range from one year for our smaller spaces to over ten years for larger tenants. Our leases generally include minimum monthly lease payments and tenant reimbursements for payment of taxes, insurance and maintenance.

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We have no employees and we do not manage our properties. Our properties and day-to-day operations are managed by the Management Company under a property management agreement.

Under the agreement in effect after September 1, 2004, we pay the Management Company the following amounts:

property management fees in an amount not to exceed the fees customarily charged in arm's length transactions by others rendering similar services in the same geographic area for similar properties as determined by a survey of brokers and agents in such area. Generally, we expect these fees to be between approximately two and four percent (2.0%-4.0%) of gross revenues for the management of commercial office buildings and approximately five percent (5.0%) of gross revenues for the management of retail and industrial properties.

for the leasing of the properties, a separate fee for the leases of new tenants and renewals of leases with existing tenants in an amount not to exceed the fee customarily charged in arm's length transactions by others rendering similar services in the same geographic area for similar properties as determined by a survey of brokers and agents in such area.

except as otherwise specifically provided, all costs and expenses incurred by the Management Company in fulfilling its duties for the account of and on behalf of us. Such costs and expenses shall include the wages and salaries and other employee-related expenses of all on-site and off-site employees of the Management Company who are engaged in the operation, management, maintenance and leasing or access control of our properties, including taxes, insurance and benefits relating to such employees, and legal, travel and other out-of-pocket expenses that are directly related to the management of specific properties.

Our management agreement in effect after September 1, 2004 defines gross revenues as all amounts actually collected as rents or other charges for the use and occupancy of our properties, but excludes interest and other investment income and proceeds received for a sale, exchange, condemnation, eminent domain taking, casualty or other disposition of assets.

Under an advisory agreement effective September 1, 2004, we pay the Management Company for asset management services a quarterly fee in an amount equal to one-fourth of 0.25% of the gross asset value calculated on the last day of each preceding quarter.

Gross asset value is defined as the amount equal to the aggregate book value of our assets (other than investments in bank accounts, money market funds or other current assets), before depreciation, bad debts or other similar non-cash reserves and without reduction for any debt relating to such assets, at the date of measurement, except that during such periods in which we are obtaining regular independent valuations of the current value of our net assets for purposes of enabling fiduciaries of employee benefit plan shareholders to comply with applicable Department of Labor reporting requirements. Gross asset value is the greater of (i) the amount determined pursuant to the foregoing or (ii) our assets' aggregate valuation established by the most recent such valuation report without reduction for depreciation, bad debts or other similar non-cash reserves and without reduction for any debt relating to such assets.

Under the agreement in effect prior to September 1, 2004, we paid the Management Company the following amounts:

a management fee of 5% of our effective gross revenues to manage our properties;

a leasing fee of 6% of the effective gross revenues from leases originated by the Management Company and a fee of 4% of the effective gross revenues from expansions or renewals of existing leases;

an administrative fee of 1% of our effective gross revenues for day-to-day supervisory and general administration services;  
and

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the reimbursement of all reasonable and necessary expenses incurred or funds advanced in connection with the management and operation of our properties, including expenses and costs relating to maintenance and construction personnel incurred on behalf of our properties; provided, however, that we will not reimburse the Management Company for its overhead, including salaries and expenses of centralized employees other than salaries of certain maintenance and construction personnel.

Our management agreement in effect prior to September 1, 2004 defines effective gross revenues as all payments actually collected from tenants and occupants of our properties, exclusive of:

security payments and deposits (unless and until such deposits have been applied to the payment of current or past due rent); and

pay received from tenants in reimbursement of the expense of repairing damage caused by tenants.

The fees payable to the Management Company under the new agreements effective September 1, 2004 were not significantly different from those that would have been payable under the former agreement.

### ***Critical Accounting Policies***

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements. We prepared these financial statements in conformity with U.S. generally accepted accounting principles. The preparation of these financial statements required us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We based our estimates on historical experience and on various other assumptions we believe to be reasonable under the circumstances. Our results may differ from these estimates. Currently, we believe that our accounting policies do not require us to make estimates using assumptions about matters that are highly uncertain. You should read Note 1, Summary of Significant Accounting Policies, to our financial statements in conjunction with this Management's Discussion and Analysis of Financial Condition and Results of Operations.

We have described below the critical accounting policies that we believe could impact our consolidated financial statements most significantly.

***Basis of Consolidation.*** We are the sole general partner of the Operating Partnership and possess full legal control and authority over its operations. As of December 31, 2004, we owned a majority of the partnership interests in the Operating Partnership. Consequently, our consolidated financial statements include the accounts of the Operating Partnership. All significant intercompany balances have been eliminated. Minority interest in the accompanying consolidated financial statements represents the share of equity and earnings of the Operating Partnership allocable to holders of partnership interests other than us. Net income is allocated to minority interests based on the weighted-average percentage ownership of the Operating Partnership during the year. Issuance of additional common shares and OP Units changes our ownership interests as well as those of minority interests.

***Real Estate.*** We record real estate properties at cost, net of accumulated depreciation. We capitalize improvements, major renovations and certain costs directly related to the acquisition, improvement and leasing of real estate. We charge expenditures for repairs and maintenance to operations as they are incurred. We calculate depreciation using the straight-line method over the estimated useful lives of 5 to 39 years of our buildings and improvements. We depreciate tenant improvements using the straight-line method over the life of the lease.

We review our properties for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets, including accrued rental income, may not be recoverable through our operations. We determine whether an impairment in value has occurred by comparing the estimated future cash flows (undiscounted and without interest charges), including the estimated residual value of the property, with the carrying cost of the property. If impairment is indicated, we record a loss for the amount by which the carrying



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value of the property exceeds its fair value. We have determined that there has been no impairment in the carrying value of our real estate assets as of December 31, 2004.

*Purchase Price Allocation.* We record above-market and below-market in-place lease values for owned properties based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. We amortize the capitalized above-market lease values as a reduction of rental income over the remaining non-cancelable terms of the respective leases. We amortize the capitalized below-market lease values as an increase to rental income over the initial term and any fixed-rate renewal periods in the respective leases. Because most of our leases are relatively short term, have inflation or other scheduled rent escalations, and cover periods during which there have been few, and generally insignificant, pricing changes in the specific properties' markets, the properties we have acquired have not been subject to leases with terms materially different than then-existing market-level terms.

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

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

We amortize the value of in-place leases, if any, to expense over the remaining initial terms of the respective leases, which, for leases with allocated intangible value, we expect to range generally from five to 10 years. The value of customer relationship intangibles is amortized to expense over the remaining initial terms and any renewal periods in the respective leases, but in no event does the amortization period for intangible assets exceed the remaining depreciable life of the building. Should a tenant terminate its lease, the unamortized portion of the in-place lease value and customer relationship intangibles are charged to expense.

*Revenue Recognition.* All leases on properties we hold are classified as operating leases, and we recognize the related rental income on a straight-line basis over the terms of the related leases. We capitalize or charge to accrued rent receivable, as applicable, differences between rental income earned and amounts due per the respective lease agreements. Percentage rents are recognized as rental income when the thresholds upon which they are based have been met. Recoveries from tenants for taxes, insurance, and other operating expenses are recognized as revenues in the period the corresponding costs are incurred. We provide an allowance for doubtful accounts against the portion of tenant accounts receivable which we estimate to be uncollectible.

### ***Liquidity and Capital Resources***

*General.* During the year ended December 31, 2004, our properties generated sufficient cash flow to cover our operating expenses and to allow us to pay quarterly distributions. We generally lease our properties on a triple-

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net basis or on bases which provide for tenants to pay for increases in operating expenses over a base year or set amount, which means that tenants are required to pay for all repairs and maintenance, property taxes, insurance and utilities, or increases thereof, applicable to their space. We anticipate that cash flows from operating activities and our borrowing capacity will continue to provide adequate capital for our working capital requirements, anticipated capital expenditures and scheduled debt payments during the next 12 months. We also believe that cash flows from operating activities and our borrowing capacity will allow us to make all distributions required for us to continue to qualify to be taxed as a REIT. We also believe that our properties are adequately covered by insurance.

*Cash and Cash Equivalents.* We had cash and cash equivalents of \$631,978 on December 31, 2004 as compared to \$578,687 on December 31, 2003 for operations and to purchase marketable securities. The increase was relatively insignificant because we try to keep cash balances to a minimum by either buying properties, improving properties, reducing debt or making distributions to shareholders. We place all cash in short-term, highly liquid investments that we believe provide appropriate safety of principal.

### *Our Debt for Borrowed Money.*

In December 2002, we refinanced most of our debt with a new credit facility from GMAC Commercial Mortgage Corporation. The loan is secured by, among other things, 18 of our properties, which are held by Hartman REIT Operating Partnership II, L.P., a wholly-owned subsidiary formed for the purpose of this credit facility, and the improvements, personal property and fixtures on the properties, all reserves, escrows and deposit accounts held by Hartman REIT Operating Partnership II, L.P., all intangible assets specific to or used in connection with the properties, and an assignment of rents related to such properties. We believe the fair market value of these properties was approximately \$62,000,000 at the time the loan was put in place. We may prepay the loan after July 1, 2005 without penalty. We must pay a prepayment fee equal to one percent of the outstanding principal balance under the facility if we prepay the note prior to July 1, 2005. As of March 1, 2005, the outstanding principal balance under this facility was \$34,440,000.

We are required to make monthly interest payments under this credit facility. During the initial term of the note, indebtedness under the credit facility will bear interest at LIBOR plus 2.5% computed on the basis of a 360 day year, adjusted monthly. The interest rate was 4.79% as of December 31, 2004. We are not required to make any principal payments prior to the loan's maturity. The credit facility will mature on January 1, 2006, though we have the option, subject to certain conditions, of extending the facility for an additional two-year period. In no event shall the interest rate be lower than 3.82% during the initial term or lower than 4.32% during the extension term.

In addition, Hartman REIT Operating Partnership II, L.P. entered into certain covenants pursuant to the credit facility which, among other things, require it to maintain specified levels of insurance and use the properties securing the note only for retail, light industrial, office, warehouse and commercial office uses. The facility also limits, without the approval of the lender, this wholly-owned subsidiary's ability to:

acquire additional material assets;

merge or consolidate with any other entity;

engage in any other business or activity other than the ownership, operation and maintenance of the properties securing the note;

make certain investments;

incur, assume or guarantee additional indebtedness;

grant certain liens; and

loan money to others.

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The security documents related to the note contain a covenant which requires Hartman REIT Operating Partnership II, L.P. to maintain adequate capital in light of its contemplated business operations. We believe that this covenant and the other restrictions provided for in our credit facility will not affect or limit Hartman REIT Operating Partnership II, L.P.'s ability to make distributions to us. The note and the security documents related thereto also contain customary events of default, including, without limitation, payment defaults, bankruptcy-related defaults and breach of covenant defaults. These covenants only apply to Hartman REIT Operating Partnership II, L.P. and do not impact the other operations of the Operating Partnership, including the operation of our 16 properties which do not secure this debt.

Upon the closing of this financing, we repaid approximately \$24,800,000 of existing debt, placed approximately \$2,800,000 in escrows established at the closing for taxes, insurance, agreed capital improvement and other uses required by the lender and paid fees and expenses of approximately \$600,000 incurred in connection with the credit facility. The remaining proceeds, approximately \$6,200,000, were available for general working capital purposes. We used the loan proceeds to repay debt and the remainder to pay accrued real estate taxes and other operating expenses.

On June 30, 2003, the Operating Partnership entered into a \$25,000,000 loan agreement with Union Planter's Bank, N.A. pursuant to which the Operating Partnership may, subject to the satisfaction of certain conditions, borrow funds to acquire additional income producing properties. The revolving loan agreement terminates in June, 2005 and provides for interest payments at a rate, adjusted monthly, of either (at the Operating Partnership's option) 30-day LIBOR plus 225 basis points, or Union Planter's Bank, N.A.'s prime rate less 50 basis points, with either rate subject to a floor of 3.75% per annum. The loan is secured by otherwise unencumbered properties currently directly owned by the Operating Partnership as well as those to be acquired with the proceeds drawn from the facility and all improvements, equipment, fixtures, building materials, consumer goods, furnishings, inventory and articles of personal property related thereto, together with all water rights, timber crops and mineral interests pertaining to the acquired properties, all deposits, bank accounts, instruments arising in virtue of transactions related to the acquired properties, all proceeds from insurance, takings or litigation arising out of the acquired properties and all leases, rents, royalties and profits or other benefits of the acquired properties. As of March 22, 2005, we had borrowed \$19,350,000 under this credit facility; and at December 31, 2004, the loan balance was \$16,700,000. We are required to make monthly payments of interest only, with the principal and all accrued unpaid interest being due at maturity of the loan. The loan may be prepaid at any time without penalty.

In addition, the Operating Partnership entered into certain covenants pursuant to the loan agreement which, among other things, require it to maintain specified levels of insurance. The facility also limits, among other things, the Operating Partnership's ability to, without the approval of the lender:

declare or pay any distribution during the continuance of a default or event of default;

acquire, consolidate with or merge into any other entity;

permit a material change in the management group;

engage in any other business or activity other than the ownership, operation and maintenance of the properties securing the note;

change the general character of its business;

materially change accounting practices, methods or standards;

sell, lease, transfer, convey or otherwise dispose of a material part of its assets other than in the ordinary course of business;

form any new subsidiary or acquire all of the assets of a third party;

permit its net worth to be less than \$70,000,000;

permit the combined occupancy of the properties securing the loan to be less than 86%;

make certain investments;

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incur, assume, guarantee or alter the terms of certain additional indebtedness;

grant certain liens; and

loan money to others.

The loan agreement and the security documents related thereto also contain customary events of default, including, without limitation, payment defaults, bankruptcy-related defaults, environmental defaults, material uninsured judgment defaults and defaults for breaches of covenant or representations.

In connection with the purchase of the Windsor Park property in December 2003, we assumed a note payable in the amount of \$6,550,000 secured by the property. The balance at December 31, 2004 was \$6,086,111. The note is payable in equal monthly installments of principal and interest of \$80,445, with interest at the rate of 8.34% per annum. The balance of the note is payable in full on December 1, 2006.

In November 2002, we borrowed \$3,278,000 from Houston R.E. Income Properties XVI, L.P. This debt was evidenced by a promissory note and accrued interest at a rate of 4.25%. The note was secured by our Corporate Park Northwest property and was payable at any time upon the demand of Houston XVI. We used these borrowed funds to repay existing debt. Mr. Hartman controls the general partner of Houston XVI. We were only required to make monthly interest payments under the note. This note was repaid in full in the second quarter of 2003.

*Capital Expenditures.* We currently do not expect to make significant capital expenditures or any significant improvements to any of our currently owned properties during the next 12 months. However, we may have unexpected capital expenditures or improvements on our existing assets. Additionally, we intend to continue our ongoing acquisition strategy of acquiring properties in the Houston and San Antonio, Texas metropolitan areas where we believe opportunities exist for acceptable investment returns (generally in the \$1,000,000 to \$10,000,000 value range), and we may incur significant capital expenditures or make significant improvements in connection with any properties we may acquire.

*Total Contractual Cash Obligations.* A summary of our contractual cash obligations, as of December 31, 2004 is as follows:

Contractual Obligations	Payment due by period				
	Total	Less than One Year	One to Three Years	Three to Five Years	More than Five Years
Long-Term Debt Obligations	\$ 57,226,111	\$ 17,134,503	\$ 40,091,608		
Capital Lease Obligations					
Operating Lease Obligations					
Purchase Obligations					
Other Long-Term Liabilities Reflected on the Registrant's Balance Sheet under GAAP					
Total	\$ 57,226,111	\$ 17,134,503	\$ 40,091,608		

We have no commercial commitments such as lines of credit or guarantees that might result from a contingent event that would require our performance pursuant to a funding commitment.

*Property Acquisitions.* During 2004, we acquired from an unrelated party one multi-tenant retail center comprising approximately 95,032 square feet of gross leasable area (GLA). The property was acquired for cash in the amount of approximately \$8,900,000.

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During 2003, we acquired from an unrelated party one multi-tenant retail center comprising approximately 192,458 square feet of GLA. The property was acquired for cash and assumption of debt of \$6,550,000 for a total consideration of approximately \$13,100,000.

We acquired ten properties from five entities operated by Mr. Hartman during 2002. We acquired four of these properties by merging the selling entities with and into either the Company or the Operating Partnership. In these mergers, we issued common shares or OP Units, as applicable, to equity holders in the selling entities who were accredited investors and paid cash for equity interests held by non-accredited investors. For all ten properties, we issued an aggregate of 1,650,879 common shares (2,358,396 after giving effect to the recapitalization), 2,851,066 OP Units (4,072,947 OP Units after giving effect to the recapitalization), including 1,067,646 OP Units (1,525,207 after giving effect to the recapitalization) issued to HCP, assumed mortgage debt and other liabilities aggregating \$15,053,870 and paid approximately \$1,811,398 to purchase interests held by non-accredited investors in connection with these mergers.

*Common Share Distributions.* We declared the following distributions to our shareholders during 2003 and 2004 (as adjusted to give effect to our reorganization as a Maryland real estate investment trust and the concurrent recapitalization of our common shares on July 28, 2004):

Month Paid or Payable	Total Amount of Distributions Paid or Payable	Distributions Per Share
April 2003	\$ 408,762	\$ 0.0583
May 2003	408,762	0.0583
June 2003	409,253	0.0584
July 2003	408,762	0.0583
August 2003	408,762	0.0583
September 2003	409,253	0.0584
October 2003	408,762	0.0583
November 2003	408,762	0.0583
December 2003	409,253	0.0584
January 2004	408,762	0.0583
February 2004	408,762	0.0583
March 2004	409,253	0.0584
April 2004	408,762	0.0583
May 2004	408,762	0.0583
June 2004	409,253	0.0584
July 2004	408,762	0.0583
August 2004	408,762	0.0583
September 2004	409,253	0.0584
October 2004	408,692	0.0583
November 2004	408,692	0.0583
December 2004	409,392	0.0584
January 2005	408,692	0.0583
February 2005	408,692	0.0583
March 2005	412,897	0.0589
<b>Average Per Quarter</b>		<b>\$ 0.1751</b>

The following sets forth the tax status of the amounts we distributed to shareholders during 2000 through 2004:

Tax Status	2004	2003	2002	2001	2000
Ordinary income	67.7%	24.8%	85.1%	70.5%	75.9%
Return of capital	32.3%	75.2%	14.9%	29.5%	24.1%
Capital gain					
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

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*OP Unit Distributions.* The Operating Partnership declared the following distributions to holders of its OP Units, including HCP, during 2003 and 2004 (as adjusted to give effect to our reorganization as a Maryland real estate investment trust and the concurrent recapitalization of our common shares on July 28, 2004):

Month Paid or Payable	Total Amount of Distributions Paid or Payable	Distributions Per Share
April 2003	\$ 726,368	\$ 0.0583
May 2003	726,368	0.0583
June 2003	727,240	0.0584
July 2003	726,368	0.0583
August 2003	726,368	0.0583
September 2003	727,240	0.0584
October 2003	726,368	0.0583
November 2003	726,368	0.0583
December 2003	727,240	0.0584
January 2004	726,368	0.0583
February 2004	726,368	0.0583
March 2004	727,240	0.0584
April 2004	726,368	0.0583
May 2004	726,368	0.0583
June 2004	727,240	0.0584
July 2004	726,368	0.0583
August 2004	726,368	0.0583
September 2004	727,240	0.0584
October 2004	726,243	0.0583
November 2004	726,243	0.0583
December 2004	727,488	0.0584
January 2005	726,243	0.0583
February 2005	726,243	0.0583
March 2005	733,717	0.0589
<b>Average Per Quarter</b>		<b>\$ 0.1751</b>

### *Results of Operations*

#### Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

#### *General*

The following table provides a general comparison of our results of operations for the years ended December 31, 2003 and December 31, 2004:

	December 31, 2003	December 31, 2004
Number of properties owned and operated	33	34
Aggregate gross leasable area (sq. ft.)	2,540,031	2,635,063
Occupancy rate	88%	86%
Total Revenues	\$ 20,972,951	\$ 23,483,657
Total Operating Expenses	\$ 14,463,982	\$ 17,069,628
Income before Minority Interest	\$ 6,508,969	\$ 6,414,029
Minority Interest in the Operating Partnership	\$ (3,034,795)	\$ (2,990,410)
Net Income	\$ 3,474,174	\$ 3,423,619

#### *Revenues*

We had rental income and tenant reimbursements of \$23,038,966 for the year ended December 31, 2004, as compared to revenues of \$20,605,161 for the year ended December 31, 2003, an increase of \$2,433,805, or 12%. Substantially all of our revenues are derived from rents received from the use of our properties. The increase in our revenues during 2004 as compared to 2003 was due to an increase in the amount of rent charged at some locations





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and the purchase of additional properties. Our average occupancy rate in 2004 was 87%, as compared to 90% in 2003, and our average annualized revenue was \$9.14 per square foot in 2004, as compared to an average annualized revenue of \$8.93 per square foot in 2003.

We had interest and other income of \$444,691 for the year ended December 31, 2004, as compared to \$367,790 for the year ended December 31, 2003, an increase of \$76,901, or 21%. At December 31, 2004, we held all revenues and escrowed funds we receive from our Public Offering through such date in money market accounts and other short-term, highly liquid investments. We expect the percentage of our total revenues from interest income from investments in money market accounts or other short-term, highly liquid investments to decrease as we invest cash holdings in properties. The increase in interest and other income during 2004 as compared to 2003 resulted primarily from an increase in non-rent income such as late fees and deposit forfeitures.

### *Expenses*

Our total operating expenses, including interest expense and depreciation and amortization expense, were \$17,069,628 for the year ended December 31, 2004, as compared to \$14,463,982 for the year ended December 31, 2003, an increase of \$2,605,646, or 18%. We expect that the dollar amount of operating expenses will increase as we acquire additional properties and expand our operations. However, we expect that general and administrative expenses as a percentage of total revenues will decline as we acquire additional properties.

The increase in our operating expenses during 2004 was primarily the result of increased maintenance, real estate taxes, utilities and depreciation and amortization expenses.

The amount we pay Hartman Management under our management agreement is based on our revenues and the book value of our assets. As a result of our increased revenues and assets in 2004, management fees were \$1,339,822 in 2004, as compared to \$1,232,127 in 2003, an increase of \$107,695, or 9%.

Our interest expense increased by \$1,340,757, or 101%, in 2004 as compared to 2003. Our average outstanding debt increased from \$37,264,685 in 2003 to \$53,705,399 in 2004 and the average interest rate associated with this debt increased from 3.90% in 2003 to 4.54% in 2004.

Finally, general and administrative expenses increased \$73,644, or 7%, in 2004 as compared to 2003, primarily as the result of an increase in professional fees.

### *Net Income*

Income provided by operating activities before minority interest was \$6,414,029 for the year ended December 31, 2004, as compared to \$6,508,969 for the year ended December 31, 2003, a decrease of \$94,940, or 1%. Net income provided by operating activities for the year ended December 31, 2004 was \$3,423,619, as compared to \$3,474,174 for the year ended December 31, 2003, a decrease of \$50,555, or 1%.

## Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

*General*

The following table provides a general comparison of our results of operations for the years ended December 31, 2002 and December 31, 2003:

	<u>December 31, 2002</u>	<u>December 31, 2003</u>
Number of properties owned and operated	32	33
Aggregate gross leasable area (sq. ft.)	2,348,862	2,540,031
Occupancy rate	92%	88%
Total Revenues	\$ 20,755,026	\$ 20,972,951
Total Operating Expenses	\$ 13,857,303	\$ 14,463,982
Income before Minority Interest	\$ 6,897,723	\$ 6,508,969
Minority Interest in the Operating Partnership	\$ (3,192,605)	\$ (3,034,795)
Net Income	\$ 3,705,118	\$ 3,474,174

*Revenues*

We had rental income and tenant reimbursements of \$20,605,161 for the year ended December 31, 2003, as compared to revenues of \$20,423,485 for the year ended December 31, 2002, an increase of \$181,676, or 1%. Substantially all of our revenues are derived from rents received from the use of our properties. The increase in our revenues during 2003 as compared to 2002 was due to an increase in the amount of rent charged at some locations. Our average occupancy rate in 2003 was 90%, as compared to 90% in 2002, and our average annualized revenue was \$8.93 per square foot in 2003, as compared to an average annualized revenue of \$8.84 per square foot in 2002.

We had interest and other income of \$367,790 for the year ended December 31, 2003, as compared to \$331,541 for the year ended December 31, 2002, an increase of \$36,249, or 11%. We hold all revenues and proceeds we receive from offerings in money market accounts and other short-term, highly liquid investments. The increase in interest and other income during 2003 as compared to 2002 resulted primarily from temporarily investing excess loan proceeds. Although more cash was invested in 2003 than in 2002, this increase was offset somewhat by the lower interest rates we earned on our investments in 2003 as compared to 2002. We expect the percentage of our total revenues from interest income from investments in money market accounts or other short-term, highly liquid investments to decrease as we invest cash holdings in properties.

*Expenses*

Our total operating expenses, including interest expense and depreciation and amortization expense, were \$14,463,982 for the year ended December 31, 2003, as compared to \$13,857,303 for the year ended December 31, 2002, an increase of \$606,679, or 4%. We expect that the dollar amount of operating expenses will increase as we acquire additional properties and expand our operations. However, we expect that general and administrative expenses as a percentage of total revenues will decline as we acquire additional properties.

The increase in our operating expenses during 2003 was primarily the result of increased maintenance, insurance, utilities and depreciation and amortization expenses. This increase was partially offset by a decrease in real estate tax expense. Real estate taxes decreased significantly for 2003 due to the settlement of several lawsuits against an appraisal district which resulted in the reduction of previously accrued property taxes.

The amount we pay Hartman Management under our management agreement is based on our revenues and the number of leases that Hartman Management originates. As a result of our increased revenues in 2003, management fees were \$1,232,127 in 2003, as compared to \$1,231,212 in 2002, an increase of \$915, or .07%.

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Our interest expense decreased by \$249,892, or 16%, in 2003 as compared to 2002. Although our average outstanding debt increased from \$29,263,144 in 2002 to \$37,264,685 in 2003, the average interest rate associated with this debt decreased from 5.38% in 2002 to 3.90% in 2003.

Finally, general and administrative expenses increased \$233,741, or 28%, in 2003 as compared to 2002, primarily as the result of an increase in professional fees.

### *Net Income*

Income provided by operating activities before minority interest was \$6,508,969 for the year ended December 31, 2003, as compared to \$6,897,723 for the year ended December 31, 2002, a decrease of \$388,754, or 6%. Net income provided by operating activities for the year ended December 31, 2003 was \$3,474,174, as compared to \$3,705,118 for the year ended December 31, 2002, a decrease of \$230,944, or 6%.

### *Taxes*

We elected to be taxed as a REIT under the Internal Revenue Code beginning with our taxable year ended December 31, 1999. As a REIT, we generally are not subject to federal income tax on income that we distribute to our shareholders. If we fail to qualify as a REIT in any taxable year, we will be subject to federal income tax on our taxable income at regular corporate rates. We believe that we are organized and operate in such a manner as to qualify to be taxed as a REIT, and we intend to operate so as to remain qualified as a REIT for federal income tax purposes.

### *Inflation*

We anticipate that our leases will continue to be triple-net leases or otherwise provide that tenants pay for increases in operating expenses and will contain provisions that we believe will mitigate the effect of inflation. In addition, many of our leases are for terms of less than five years, which allows us to adjust rental rates to reflect inflation and other changing market conditions when the leases expire. Consequently, increases due to inflation, as well as ad valorem tax rate increases, generally do not have a significant adverse effect upon our operating results.

### *Environmental Matters*

Our properties are subject to environmental laws and regulations adopted by various governmental authorities in the jurisdictions in which our operations are conducted. From our inception, we have incurred no significant environmental costs, accrued liabilities or expenditures to mitigate or eliminate future environmental contamination.

### *Off-Balance Sheet Arrangements*

The Company has no significant off-balance sheet arrangements as of December 31, 2004.

### *Recent Accounting Pronouncements*

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123R, "*Share Based Payment*." This statement requires companies to categorize share based payment as either liability or equity awards. For liability awards, companies will remeasure the award at fair value at each balance sheet date until the award is settled. Equity classified awards are measured at the grant-date fair value and are not remeasured. SFAS No. 123R is effective for interim or annual periods beginning after June 15, 2005. Awards issued, modified or settled after the effective date will be measured and recorded in accordance with SFAS No. 123R. Management believes that the implementation of this standard will not have a material effect on the Company's consolidated financial position or results of operations.

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In December 2004, the FASB issued SFAS No. 153, "Accounting for Non-monetary Transactions." This standard requires that non-monetary exchanges be accounted for at fair value, recognizing any gain or loss, if the transactions meet a commercial-substance criteria and fair value is determinable. SFAS No. 153 is effective for non-monetary transactions occurring in fiscal years beginning after June 15, 2005. Management believes that the implementation of this standard will not have a material effect on the Company's consolidated financial position or results of operations.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

Market risk is the risk of loss arising from adverse changes in market rates and prices. The principal market risk to which the Company is exposed is the risk related to interest rate fluctuations. The Company will be exposed to changes in interest rates as a result of the Company's credit facilities that have floating interest rates. As of December 31, 2004, the Company had \$51,140,000 of indebtedness outstanding under such facilities. The impact of a 1% increase in interest rates on the Company's debt would result in an increase in interest expense and a decrease in income before minority interests of approximately \$511,400 annually.

### **Item 8. Financial Statements and Supplementary Data.**

The information required by this Item 8 is hereby incorporated by reference to the Company's Financial Statements beginning on page F-1 of this Annual Report on Form 10-K.

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

### **Item 9A. Controls and Procedures.**

In accordance with Rules 13a-15 and 15d-15 under the Securities and Exchange Act, we carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2004. No change in our internal control over financial reporting occurred during the fourth fiscal quarter of the period covered by this annual report that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### **Item 9B. Other Information.**

None.

**PART III**

**Item 10. Directors and Executive Officers of the Registrant.**

The information required by this Item will be presented in the Company's definitive proxy statement for the Company's annual meeting of shareholders, which will be filed with the Securities and Exchange Commission no later than April 30, 2005, and is incorporated herein by reference to the sections of the proxy statement entitled "Election of Trustees" and "Section 16(a) Beneficial Ownership and Reporting Compliance." The Company plans to hold its annual meeting of stockholders approximately 30 days after it files its definitive proxy statement with the Securities and Exchange Commission.

**Item 11. Executive Compensation.**

The information required by this Item will be presented in the Company's definitive proxy statement for the Company's annual meeting of shareholders, which will be filed with the Securities and Exchange Commission no later than April 30, 2005, and is incorporated herein by reference the section of the proxy statement entitled "Executive Compensation." The Company plans to hold its annual meeting of stockholders approximately 30 days after it files its definitive proxy statement with the Securities and Exchange Commission.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information required by this Item will be presented in the Company's definitive proxy statement for the Company's annual meeting of shareholders, which will be filed with the Securities and Exchange Commission no later than April 30, 2005, and is incorporated herein by reference the sections of the proxy statement entitled "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plan Information as of December 31, 2004." The Company plans to hold its annual meeting of stockholders approximately 30 days after it files its definitive proxy statement with the Securities and Exchange Commission.

**Item 13. Certain Relationships and Related Transactions.**

The information required by this Item will be presented in the Company's definitive proxy statement for the Company's annual meeting of shareholders, which will be filed with the Securities and Exchange Commission no later than April 30, 2005, and is incorporated herein by reference the section of the proxy statement entitled "Certain Transactions." The Company plans to hold its annual meeting of stockholders approximately 30 days after it files its definitive proxy statement with the Securities and Exchange Commission.

**Item 14. Principal Accounting Fees and Services.**

The information required by this Item will be presented in the Company's definitive proxy statement for the Company's annual meeting of shareholders, which will be filed with the Securities and Exchange Commission no later than April 30, 2005, and is incorporated herein by reference the sections of the proxy statement entitled "Principal Accountants' Fees and Services." The Company plans to hold its annual meeting of stockholders approximately 30 days after it files its definitive proxy statement with the Securities and Exchange Commission.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules.**

(a)

*List of Documents Filed.*

1. Financial Statements. The list of the Company's financial statements filed as part of this Annual Report on Form 10-K is set forth on page F-1 herein.
2. Financial Statement Schedules. See (d) below.
  - a. Schedule II Valuation and Qualifying Amounts
  - b. Schedule III Real Estate and Accumulated Depreciation
3. Exhibits. The list of exhibits filed as part of this Annual Report on Form 10-K in response to Item 601 of Regulation S-K is submitted on the Exhibit Index attached hereto.

(b)

*Exhibits.*

The exhibits filed in response to Item 601 of Regulation S-K are listed on the Exhibit Index attached hereto.

(c)

*Financial Statement Schedules.*

1. Schedule II Valuation and Qualifying Amounts
2. Schedule III Real Estate and Accumulated Depreciation

All other financial statement schedules have been omitted because the required information of such schedules is not present, is not present in amounts sufficient to require a schedule or is included in the consolidated financial statements.

**SIGNATURES**

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

HARTMAN COMMERCIAL PROPERTIES REIT

Dated: March 31, 2005

By: /s/ ALLEN R. HARTMAN

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Allen R. Hartman, President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

March 31, 2005

/s/ ALLEN R. HARTMAN

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Allen R. Hartman, President and Trustee  
(Principal Executive Officer)

March 31, 2005

/s/ ROBERT W. ENGEL

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Robert W. Engel, Chief Financial Officer and Trustee  
(Principal Financial and Principal Accounting Officer)

March 31, 2005

/s/ CHRIS A. MINTON

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Chris A. Minton, Trustee

March 31, 2005

/s/ JACK L. MAHAFFEY

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Jack L. Mahaffey, Trustee

March 31, 2005

/s/ SAMUEL C. HATHORN

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Samuel C. Hathorn, Trustee

March 31, 2005

/s/ CHAND VYAS

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Chand Vyas, Trustee

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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<u>Consolidated Balance Sheets as of December 31, 2004 and 2003</u>	F-2
<u>Consolidated Statements of Income for the Years Ended December 31, 2004, 2003 and 2002</u>	F-4
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All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

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**Report of Independent Registered Public Accounting Firm**

To the Board of Trustees and Shareholders of  
Hartman Commercial Properties REIT

We have audited the accompanying consolidated balance sheets of Hartman Commercial Properties REIT and subsidiary (the "Company") as of December 31, 2004 and 2003, and the related consolidated statements of income, shareholders' equity and cash flows, for each of the three years in the period ended December 31, 2004. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedules as listed in the accompanying index. These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Hartman Commercial Properties REIT and subsidiary as of December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in the relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/s/ PANNELL KERR FORSTER OF TEXAS, P.C.

Houston, Texas  
February 11, 2005

## Hartman Commercial Properties REIT and Subsidiary

## Consolidated Balance Sheets

	December 31,	
	2004	2003
Assets		
Real estate		
Land	\$ 28,446,210	\$ 26,664,999
Buildings and improvements	113,551,420	105,055,635
	<u>141,997,630</u>	<u>131,720,634</u>
Less accumulated depreciation	(15,450,416)	(11,464,280)
	<u>126,547,214</u>	<u>120,256,354</u>
Real estate, net		
Cash and cash equivalents	631,978	578,687
Escrows and acquisition deposits	4,978,362	3,188,649
Note receivable	655,035	687,003
Receivables		
Accounts receivable, net of allowance for doubtful accounts of \$342,690 and \$350,750 in 2004 and 2003, respectively	1,008,621	526,855
Accrued rent receivable	2,594,933	1,963,214
Due from affiliates	3,300,202	3,679,602
	<u>6,903,756</u>	<u>6,169,671</u>
Receivables, net		
Deferred costs, net	2,797,294	3,039,661
Prepaid expenses and other assets	103,301	146,366
	<u>2,900,595</u>	<u>3,186,027</u>
Total assets	<u>\$ 142,616,940</u>	<u>\$ 134,066,391</u>

*See notes to consolidated financial statements.*

## Hartman Commercial Properties REIT and Subsidiary

## Consolidated Balance Sheets (continued)

	December 31,	
	2004	2003
Liabilities and Shareholders' Equity		
Liabilities		
Notes payable	\$ 57,226,111	\$ 47,343,182
Accounts payable and accrued expenses	3,354,610	3,324,461
Due to affiliates	675,861	757,451
Tenants' security deposits	1,066,147	1,061,209
Prepaid rent	254,765	453,421
Offering proceeds escrowed	1,471,696	
Dividends payable	1,230,281	1,226,777
Other liabilities	1,019,363	1,016,460
<b>Total liabilities</b>	<b>66,298,834</b>	<b>55,182,961</b>
Minority interests of unit holders in Operating Partnership, 5,808,337 units at December 31, 2004 and 2003	36,489,114	37,567,446
Commitments and contingencies		
Shareholders' equity		
Preferred shares, \$0.001 par value per share; 50,000,000 shares authorized; none issued and outstanding at December 31, 2004 and 2003		
Common shares, \$0.001 par value per share; 400,000,000 shares authorized; 7,010,146 issued and outstanding at December 31, 2004 and 2003	7,010	7,010
Additional paid-in capital	45,527,152	45,527,152
Accumulated deficit	(5,705,170)	(4,218,178)
<b>Total shareholders' equity</b>	<b>39,828,992</b>	<b>41,315,984</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 142,616,940</b>	<b>\$ 134,066,391</b>

*See notes to consolidated financial statements.*

## Hartman Commercial Properties REIT and Subsidiary

## Consolidated Statements of Income

	Year Ended December 31,		
	2004	2003	2002
<b>Revenues</b>			
Rental income	\$ 18,426,558	\$ 16,656,340	\$ 16,794,963
Tenants' reimbursements	4,612,408	3,948,821	3,628,522
Interest and other income	444,691	367,790	331,541
<b>Total revenues</b>	<b>23,483,657</b>	<b>20,972,951</b>	<b>20,755,026</b>
<b>Expenses</b>			
Operation and maintenance	2,838,618	2,505,756	2,299,377
Interest expense	2,664,135	1,323,378	1,573,270
Real estate taxes	2,595,346	2,050,738	2,629,122
Insurance	459,801	509,498	381,155
Electricity, water and gas utilities	817,484	805,772	795,431
Management and partnership and asset management fees to an affiliate	1,339,822	1,232,127	1,231,212
General and administrative	1,139,060	1,065,416	831,675
Depreciation	3,986,136	3,728,925	3,550,325
Amortization	1,237,286	1,029,122	491,536
Bad debt expense (recoveries)	(8,060)	213,250	74,200
<b>Total operating expenses</b>	<b>17,069,628</b>	<b>14,463,982</b>	<b>13,857,303</b>
Income before minority interests	6,414,029	6,508,969	6,897,723
Minority interests in Operating Partnership	(2,990,410)	(3,034,795)	(3,192,605)
<b>Net income</b>	<b>\$ 3,423,619</b>	<b>\$ 3,474,174</b>	<b>\$ 3,705,118</b>
<b>Net income per common share</b>	<b>\$ 0.488</b>	<b>\$ 0.496</b>	<b>\$ 0.529</b>
<b>Weighted-average shares outstanding</b>	<b>7,010,146</b>	<b>7,010,146</b>	<b>7,007,167</b>

*See notes to consolidated financial statements.*

## Hartman Commercial Properties REIT and Subsidiary

## Consolidated Statements of Changes in Shareholders' Equity

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount			
Balance, December 31, 2001	4,627,590	4,628	\$ 28,865,935	\$ (1,767,759)	\$ 27,102,804
Issuance of common stock for cash, net of offering costs	24,160	24	154,785		154,809
Issuance of common stock to acquire Operating Partnership units	1,525,207	1,525	10,674,935		10,676,460
Issuance of common stock in exchange for Operating Partnership units	833,189	833	5,831,497		5,832,330
Net income				3,705,118	3,705,118
Dividends				(4,722,603)	(4,722,603)
Balance, December 31, 2002	7,010,146	7,010	45,527,152	(2,785,244)	42,748,918
Net income				3,474,174	3,474,174
Dividends				(4,907,108)	(4,907,108)
Balance, December 31, 2003	7,010,146	7,010	45,527,152	(4,218,178)	41,315,984
Net income				3,423,619	3,423,619
Dividends				(4,910,611)	(4,910,611)
Balance, December 31, 2004	7,010,146	\$ 7,010	\$ 45,527,152	\$ (5,705,170)	\$ 39,828,992

See notes to consolidated financial statements.

## Hartman Commercial Properties REIT and Subsidiary

## Consolidated Statements of Cash Flows

	Year Ended December 31,		
	2004	2003	2002
<b>Cash flows from operating activities:</b>			
Net income	\$ 3,423,619	\$ 3,474,174	\$ 3,705,118
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation	3,986,136	3,728,925	3,550,325
Amortization	1,237,286	1,029,122	491,536
Minority interests in Operating Partnership	2,990,410	3,034,795	3,192,605
Equity in income of real estate partnership	(209,737)		
Bad debt expense (recoveries)	(8,060)	213,250	74,200
Changes in operating assets and liabilities:			
Escrows and acquisition deposits	(317,739)	(223,663)	(956,051)
Receivables	(1,105,425)	(387,143)	(682,683)
Due from affiliates	297,810	(939,038)	847,608
Deferred costs	(952,756)	(978,398)	(894,076)
Prepaid expenses and other assets	352,586	(15,336)	77,130
Accounts payable and accrued expenses	30,149	23,215	987,052
Tenants' security deposits	4,938	(60,295)	67,876
Prepaid rent	(198,656)	88,828	125,406
Net cash provided by operating activities	9,530,561	8,988,436	10,586,046
<b>Cash flows used in investing activities:</b>			
Additions to real estate	(10,276,996)	(8,242,179)	(1,982,508)
Proceeds from sale of property			60,000
Investment in real estate partnership	(9,033,561)		
Distributions received from real estate partnership	9,233,555		
Issuance of note receivable		(290,000)	
Repayment of note receivable	31,968	22,997	
Net cash used in investing activities	(10,045,034)	(8,509,182)	(1,922,508)
<b>Cash flows from financing activities:</b>			
Dividends paid	(4,907,107)	(4,907,108)	(4,437,575)
Distributions paid to OP unit holders	(4,065,839)	(4,065,840)	(3,998,069)
Purchase of nonaccredited investors' shares			(1,452,960)
Proceeds from issuance of common shares			154,809
Proceeds from stock offering	1,471,696		
Proceeds from stock offering escrowed	(1,471,974)		
Proceeds from notes payable	19,013,180	6,353,182	18,742,991
Proceeds from (repayment of) note payable to affiliate		(3,278,000)	3,278,000
Repayments of notes payable	(9,430,029)		(14,639,488)
Payments of loan origination costs	(42,163)	(94,500)	(422,965)
Net cash provided by (used in) financing activities	567,764	(5,992,266)	(2,775,257)
Net increase (decrease) in cash	53,291	(5,513,012)	5,888,281
Cash and cash equivalents at beginning of year	578,687	6,091,699	203,418

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Year Ended December 31,

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Cash and cash equivalents at end of year	\$	631,978	\$	578,687	\$	6,091,699
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*See notes to consolidated financial statements.*

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**Hartman Commercial Properties REIT and Subsidiary**

**Consolidated Statements of Cash Flows  
(Continued)**

	Year Ended December 31,		
	2004	2003	2002
<b>Supplemental disclosure of cash flow information</b>			
Debt assumed in connection with acquisition of properties	\$	\$ 6,550,000	\$ 13,595,156
OP Units issued in connection with acquisition of properties	\$	\$	\$ 28,510,660
Shares issued in connection with acquisition of properties	\$	\$	\$ 10,676,460

*See notes to consolidated financial statements.*



**Hartman Commercial Properties REIT and Subsidiary**

**Notes to Consolidated Financial Statements**

**December 31, 2004**

**Note 1 Summary of Significant Accounting Policies**

*Description of business and nature of operations*

Hartman Commercial Properties REIT ("HCP") was formed as a real estate investment trust, pursuant to the Texas Real Estate Investment Trust Act on August 20, 1998 to consolidate and expand the real estate investment strategy of Allen R. Hartman ("Hartman") in acquiring and managing office and retail properties. In July 2004, HCP changed its state of organization from Texas to Maryland pursuant to a merger of HCP directly with and into a Maryland real estate investment trust formed for the sole purpose of the reorganization and the conversion of each outstanding common share of beneficial interest of the Texas entity into 1.42857 common shares of beneficial interest of the Maryland entity (see Note 11). Hartman, HCP's Chairman of the Board of Trustees, has been engaged in the ownership, acquisition, and management of commercial properties in the Houston, Texas, metropolitan area for over 20 years. HCP serves as the general partner of Hartman REIT Operating Partnership, L.P. (the "Operating Partnership" or "HROP" or "OP"), which was formed on December 31, 1998 as a Delaware limited partnership. HCP and the Operating Partnership are collectively referred to herein as the "Company." HCP currently conducts substantially all of its operations and activities through the Operating Partnership. As the general partner of the Operating Partnership, HCP has the exclusive power to manage and conduct the business of the Operating Partnership, subject to certain customary exceptions. Hartman Management, L.P. (the "Management Company"), a company wholly-owned by Hartman, provides a full range of real estate services for the Company, including leasing and property management, accounting, asset management and investor relations. As of December 31, 2004, 2003 and 2002, the Company owned and operated 34, 33 and 32 office and retail properties in and around Houston and San Antonio, Texas.

*Basis of consolidation*

HCP is the sole general partner of the Operating Partnership and possesses full legal control and authority over the operations of the Operating Partnership. As of December 31, 2004, HCP owned a majority of the partnership interests in the Operating Partnership. Consequently, the accompanying consolidated financial statements of HCP include the accounts of the Operating Partnership. All significant intercompany balances have been eliminated. Minority interest in the accompanying consolidated financial statements represents the share of equity and earnings of the Operating Partnership allocable to holders of partnership interests other than the Company. Net income is allocated to minority interests based on the weighted-average percentage ownership of the Operating Partnership during the year. Issuance of additional common shares of beneficial interest in HCP ("common shares") and units of limited partnership interest in the Operating Partnership ("OP Units") changes the ownership interests of both the minority interests and HCP.

*Basis of accounting*

The financial records of the Company are maintained on the accrual basis of accounting whereby revenues are recognized when earned and expenses are recorded when incurred.

*Cash and cash equivalents*

The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents at December 31, 2004 and 2003 consist of demand deposits at commercial banks and money market funds.

## Hartman Commercial Properties REIT and Subsidiary

## Notes to Consolidated Financial Statements

December 31, 2004

**Note 1 Summary of Significant Accounting Policies (Continued)***Due from affiliates*

Due from affiliates include amounts owed to the Company from Hartman operated limited partnerships and other entities.

*Escrows and acquisition deposits*

Escrow deposits include escrows established pursuant to certain mortgage financing arrangements for real estate taxes, insurance, maintenance and capital expenditures. Escrow deposits also include the proceeds of the Public Offering until investors are admitted as shareholders as described in Note 11. The balance in the Public Offering escrow account was \$1,471,974 at December 31, 2004 as follows:

Gross offering proceeds	\$ 1,474,320
Less discounts	(2,624)
	<hr/>
Net offering proceeds	1,471,696
Plus interest earned	278
	<hr/>
Balance in escrow account at December 31, 2004	\$ 1,471,974
	<hr/>

Acquisition deposits include earnest money deposits on future acquisitions.

*Real estate*

Real estate properties are recorded at cost, net of accumulated depreciation. Improvements, major renovations, and certain costs directly related to the acquisition, improvement, and leasing of real estate are capitalized. Expenditures for repairs and maintenance are charged to operations as incurred. Depreciation is computed using the straight-line method over the estimated useful lives of 5 to 39 years for the buildings and improvements. Tenant improvements are depreciated using the straight-line method over the life of the lease.

Management reviews its properties for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets, including accrued rental income, may not be recoverable through operations. Management determines whether an impairment in value has occurred by comparing the estimated future cash flows (undiscounted and without interest charges), including the estimated residual value of the property, with the carrying cost of the property. If impairment is indicated, a loss will be recorded for the amount by which the carrying value of the property exceeds its fair value. Management has determined that there has been no impairment in the carrying value of the Company's real estate assets as of December 31, 2004.

*Deferred costs*

Deferred costs consist primarily of leasing commissions paid to the Management Company and deferred financing costs. Leasing commissions are amortized on the straight-line method over the terms of the related lease agreements. Deferred financing costs are amortized on the straight-line method over the terms of the loans, which approximates the interest method. Costs allocated to in-place leases whose terms differ from market terms related to acquired properties are amortized over the remaining life of the respective leases.

*Offering costs*

Offering costs include selling commissions, issuance costs, investor relations fees and unit purchase discounts. These costs were incurred in the raising of capital through the sale of common shares and are treated as a reduction of shareholders' equity.

**Hartman Commercial Properties REIT and Subsidiary**

**Notes to Consolidated Financial Statements**

**December 31, 2004**

**Note 1 Summary of Significant Accounting Policies (Continued)**

*Revenue recognition*

All leases on properties held by the Company are classified as operating leases, and the related rental income is recognized on a straight-line basis over the terms of the related leases. Differences between rental income earned and amounts due per the respective lease agreements are capitalized or charged, as applicable, to accrued rent receivable. Percentage rents are recognized as rental income when the thresholds upon which they are based have been met. Recoveries from tenants for taxes, insurance, and other operating expenses are recognized as revenues in the period the corresponding costs are incurred. The Company provides an allowance for doubtful accounts against the portion of tenant accounts receivable which is estimated to be uncollectible.

*Federal income taxes*

HCP is qualified as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986 and is therefore not subject to Federal income taxes provided it meets all conditions specified by the Internal Revenue Code for retaining its REIT status. HCP believes it has continuously met these conditions since reaching 100 shareholders in 1999 (see Note 9).

*Use of estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates used by the Company include the estimated useful lives for depreciable and amortizable assets and costs, and the estimated allowance for doubtful accounts receivable. Actual results could differ from those estimates.

*Fair value of financial instruments*

The Company's financial instruments consist primarily of cash, cash equivalents, accounts receivable and accounts and notes payable. The carrying value of cash, cash equivalents, accounts receivable and accounts payable are representative of their respective fair values due to the short-term nature of these instruments. The fair value of the Company's debt obligations is representative of its carrying value based upon current rates offered for similar types of borrowing arrangements.

*Concentration of risk*

Substantially all of the Company's revenues are obtained from office, office/warehouse and retail locations in the Houston, Texas and San Antonio, Texas metropolitan areas.

Hartman Commercial Properties REIT and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2004

**Note 1 Summary of Significant Accounting Policies (Continued)**

*Concentration of risk (continued)*

The Company maintains cash accounts in major U.S. financial institutions. The terms of these deposits are on demand to minimize risk. The balances of these accounts occasionally exceed the federally insured limits, although no losses have been incurred in connection with such cash balances.

*Comprehensive income*

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 130, "*Reporting Comprehensive Income*" in 1999. For the years presented, the Company did not have significant amounts of comprehensive income.

*New accounting pronouncements*

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 123R, "*Share Based Payment*." This statement requires companies to categorize share based payment as either liability or equity awards. For liability awards, companies will remeasure the award at fair value at each balance sheet date until the award is settled. Equity classified awards are measured at the grant-date fair value and are not remeasured. SFAS No. 123R is effective for interim or annual periods beginning after June 15, 2005. Awards issued, modified or settled after the effective date will be measured and recorded in accordance with SFAS No. 123R. Management believes that the implementation of this standard will not have a material effect on the Company's consolidated financial position or results of operations.

In December 2004, the FASB issued SFAS No. 153, "*Accounting for Non-monetary Transactions*." This standard requires that non-monetary exchanges be accounted for at fair value, recognizing any gain or loss, if the transactions meet a commercial-substance criteria and fair value is determinable. SFAS No. 153 is effective for non-monetary transactions occurring in fiscal years beginning after June 15, 2005. Management believes that the implementation of this standard will not have a material effect on the Company's consolidated financial position or results of operations.

Hartman Commercial Properties REIT and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2004

**Note 2 Real Estate**

During 2002, the Company completed a series of transactions to acquire ten commercial real estate properties from affiliated partnerships. Approximately 883,494 square feet of gross leaseable area ("GLA") was acquired for the following consideration:

2,851,066 (4,072,947 after giving effect to the Company's recapitalization in July 2004)	
HCP shares of beneficial interest and HROP partnership units convertible one for one into HCP shares	\$ 28,510,660
Assumption of mortgage debt	13,595,156
Cash	1,811,398
Other liabilities assumed, net of other assets acquired	1,458,714
	<hr/>
<b>Total</b>	<b>\$ 45,375,928</b>
	<hr/>

During 2003, the Company acquired from an unrelated party one multi-tenant retail center comprising approximately 192,458 square feet of GLA. The property was acquired for cash and assumption of debt of \$6,550,000 for a total consideration of approximately \$13,100,000.

During 2004, the Company acquired from an unrelated party one multi-tenant retail center comprising approximately 95,032 square feet of GLA. The property was acquired for cash in the amount of approximately \$8,900,000.

**Hartman Commercial Properties REIT and Subsidiary**

**Notes to Consolidated Financial Statements**

**December 31, 2004**

**Note 2 Real Estate (Continued)**

The purchase prices the Company paid for the properties were determined by, among other procedures, estimating the amount and timing of expected cash flows from the acquired properties, discounted at market rates. This process in general also results in the assessment of fair value for each property.

The Company allocates the purchase price of real estate to the acquired tangible assets, consisting of land, building and tenant improvements, and identified intangible assets and liabilities, generally consisting of the value of above-market and below-market leases, other value of in-place leases and value of tenant relationships, based in each case on management's estimates of their fair values.

Management estimates the fair value of acquired tangible assets by valuing the acquired property as if it were vacant. The "as-if-vacant" value (limited to the purchase price) is allocated to land, building, and tenant improvements based on management's determination of the relative fair values of these assets.

Above-market and below-market in-place lease values for owned properties are recorded based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over a period equal to the remaining non-cancelable term of the lease. The capitalized above-market lease values are amortized as a reduction of rental income over the remaining non-cancelable terms of the respective leases. The capitalized below-market lease values are amortized as an increase to rental income over the initial term and any fixed-rate renewal periods in the respective leases.

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

**Hartman Commercial Properties REIT and Subsidiary**

**Notes to Consolidated Financial Statements**

**December 31, 2004**

**Note 2 Real Estate (Continued)**

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

The value of in-place leases, if any, is amortized to expense over the remaining initial term of the respective leases, which, for leases with allocated intangible value, are expected to range generally from five to 10 years. The value of customer relationship intangibles is amortized to expense over the remaining initial term and any renewal periods in the respective leases, but in no event does the amortization period for intangible assets exceed the remaining depreciable life of the building. Should a tenant terminate its lease, the unamortized portion of the in-place lease value and customer relationship intangibles are charged to expense.

Effective November 19, 2002, the Company sold one of the properties acquired during 2002 to an unrelated third party. The sales price of the property of \$780,000 equaled its carrying value and initial cost and no gain or loss from disposition was recorded. The Company purchased the property from a related party two months earlier. Revenues and operating expenses of the property were minimal and are recorded in the consolidated statements of income for the year ended December 31, 2002. Consideration from the sale included a note receivable from the purchaser in the amount of \$420,000 (see Note 4) and \$360,000 in cash.

At December 31, 2004, the Company owned 34 commercial properties in the Houston and San Antonio, Texas areas comprising approximately 2,635,000 square feet of GLA.

**Note 3 Investment in Real Estate Partnership**

During January 2004, the Company contributed approximately \$9,000,000 to Hartman Gulf Plaza Acquisitions LP, a Texas limited partnership, in which it is a limited partner with a 73.11% percentage interest. On January 30, 2004, the partnership purchased Gulf Plaza, a 120,651 square foot office building located in Houston, Texas. The purpose of the partnership is to acquire and sell tenant-in-common interests in the building. The Company has received approximately \$9,200,000 in distributions from the partnership for the year ended December 31, 2004.

The Company's equity in income of the partnership of \$209,737 for the year ended December 31, 2004 is included in other income on the consolidated statement of income. The Company's remaining investment in the partnership of \$9,743 as of December 31, 2004 is included in other assets on the consolidated balance sheet. The partnership owns a one-percent tenant-in-common interest in the building.

**Note 4 Note Receivable**

In January 2003, the Company partially financed the sale of a property it had previously sold and for which it had taken a note receivable of \$420,000 as part of the consideration. The Company advanced \$290,000 and renewed and extended the balance of \$420,000 still due from the original sale.

The original principal amount of the note receivable, dated January 10, 2003, is \$710,000. The note is payable in monthly installments of \$6,382, including interest at 7% per annum, for the first two years of the note. Thereafter, monthly installments of \$7,489 are due with interest at 10% per annum. The note is fully amortizing with the final payment due January 10, 2018.

## Hartman Commercial Properties REIT and Subsidiary

## Notes to Consolidated Financial Statements

December 31, 2004

**Note 5 Deferred Costs**

Deferred costs consist of the following:

	December 31,	
	2004	2003
Leasing commissions	\$ 4,333,305	\$ 3,380,549
Deferred financing costs	1,485,381	1,443,218
	5,818,686	4,823,767
Less: accumulated amortization	(3,021,392)	(1,784,106)
	\$ 2,797,294	\$ 3,039,661

**Note 6 Future Minimum Lease Income**

The Company leases the majority of its office and retail properties under noncancelable operating leases which provide for minimum base rentals plus, in some instances, contingent rentals based upon a percentage of the tenants' gross receipts.

A summary of minimum future rentals to be received (exclusive of renewals, tenant reimbursements, and contingent rentals) under noncancelable operating leases in existence at December 31, 2004 is as follows:

Years Ended December 31,	
2005	\$ 17,282,303
2006	14,002,419
2007	11,352,173
2008	7,746,235
2009	5,169,253
Thereafter	9,858,969
	\$ 65,411,352

**Note 7 Debt***Notes payable*

Mortgages and other notes payable consist of the following:

	December 31,	
	2004	2003
Mortgages and other notes payable	\$ 40,526,111	\$ 40,990,000
Revolving loan secured by properties	16,700,000	6,353,182



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December 31,

Total	\$	57,226,111	\$	47,343,182
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Hartman Commercial Properties REIT and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2004

Note 7 Debt (Continued)

In December 2002, the Company refinanced substantially all of its mortgage debt with a \$34,440,000 three-year floating rate mortgage loan collateralized by 18 of the Company's properties and a maturity date of January 1, 2006. The loan bears interest at 2.5% over a LIBOR rate (4.79% and 3.82% at December 31, 2004 and 2003, respectively) computed on the basis of a 360-day year and has a two-year extension option. Interest only payments are due monthly for the first 30 month period after the origination date, after which the loan may be repaid in full or in \$100,000 increments, with a final balloon payment due upon maturity. The Company capitalized loan costs of \$1,271,043 financed from the proceeds of the refinancing. The security documents related to the mortgage loan contain a covenant that requires Hartman REIT Operating Partnership II, L.P., a wholly-owned subsidiary formed for the purpose of this credit facility, to maintain adequate capital in light of its contemplated operations. This covenant and the other restrictions provided for in the credit facility do not affect Hartman REIT Operating Partnership II, L.P.'s ability to make distributions to the Company.

On June 30, 2003, the Company entered into a \$25,000,000 loan agreement with a bank pursuant to which the Company may, subject to the satisfaction of certain conditions, borrow funds to acquire additional income producing properties. The revolving loan agreement terminates in June 2005 and provides for interest payments at a rate, adjusted monthly, of either (at the Company's option) 30-day LIBOR plus 225 basis points, or the bank's prime rate less 50 basis points, with either rate subject to a floor of 3.75% per annum. The loan will be secured by currently owned, unencumbered properties and by properties acquired with the proceeds drawn from the facility. As of December 31, 2004, the Company had borrowed \$16,700,000 under this credit facility. The Company is required to make monthly payments of interest only, with the principal and all accrued unpaid interest being due at maturity of the loan. The loan may be prepaid at any time without penalty.

In connection with the purchase of the Windsor Park property in December 2003, the Company assumed a note payable in the amount of \$6,550,000 secured by the property. The balance at December 31, 2004 was \$6,086,111. The note is payable in equal monthly installments of principal and interest of \$80,445, with interest at the rate of 8.34% per annum. The balance of the note is payable in full on December 1, 2006.

As of December 31, 2004, annual maturities of notes payable, including the revolving loan, are as follows:

Year Ended December 31,	
2005	\$ 17,134,503
2006	40,091,608
	<u>\$ 57,226,111</u>

## Hartman Commercial Properties REIT and Subsidiary

## Notes to Consolidated Financial Statements

December 31, 2004

**Note 7 Debt (Continued)***Note payable to affiliate*

In November 2002, the Company issued a \$3,278,000 note payable bearing interest at 4.25% per annum to Houston R.E. Income Properties XVI, Ltd., a related party operated by Hartman. The note was secured by property and due upon demand with interest only payments due monthly. The note was repaid in the second quarter of 2003.

*Supplemental cash flow information*

The Company made cash payments for interest on debt of \$2,728,985, \$1,321,758 and \$1,636,904 for the years ended December 31, 2004, 2003 and 2002, respectively.

**Note 8 Earnings Per Share**

Basic earnings per share is computed using net income to common shareholders and the weighted average number of common shares outstanding. Diluted earnings per share reflects common shares issuable from the assumed conversion of OP Units convertible into common shares. Only those items that have a dilutive impact on basic earnings per share are included in the diluted earnings per share. Accordingly, because conversion of OP Units into common shares is antidilutive, no OP Units were included in the diluted earnings per share calculations.

	Year Ended December 31,		
	2004	2003	2002
Basic and diluted earnings per share			
Weighted average common shares outstanding	7,010,146	7,010,146	7,007,167
Basic and diluted earnings per share	\$ 0.488	\$ 0.496	\$ 0.529
Net income	\$ 3,423,619	\$ 3,474,174	\$ 3,705,118

**Note 9 Federal Income Taxes**

Federal income taxes are not provided because the Company intends to and believes it qualifies as a REIT under the provisions of the Internal Revenue Code. Shareholders of the Company include their proportionate taxable income in their individual tax returns. As a REIT, the Company must distribute at least 90% of its ordinary taxable income to its shareholders and meet certain income sources and investment restriction requirements. In addition, REITs are subject to a number of organizational and operational requirements. If the Company fails to qualify as a REIT in any taxable year, the Company will be subject to federal income tax (including any applicable alternative minimum tax) on its taxable income at regular corporate tax rates.

Taxable income differs from net income for financial reporting purposes principally due to differences in the timing of recognition of interest, real estate taxes, depreciation and rental revenue.

## Hartman Commercial Properties REIT and Subsidiary

## Notes to Consolidated Financial Statements

December 31, 2004

**Note 9 Federal Income Taxes (Continued)**

For Federal income tax purposes, the cash dividends distributed to shareholders are characterized as follows for the years ended December 31:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Ordinary income (unaudited)	67.7%	24.8%	85.1%
Return of capital (unaudited)	32.3%	75.2%	14.9%
Capital gain distributions (unaudited)	0%	0%	0%
	<u>        </u>	<u>        </u>	<u>        </u>
Total	100%	100%	100%
	<u>        </u>	<u>        </u>	<u>        </u>

**Note 10 Related-Party Transactions**

In January 1999, the Company entered into a property management agreement with the Management Company. Effective September 1, 2004, this agreement was amended and restated. Prior to September 1, 2004, in consideration for supervising the management and performing various day-to-day affairs, the Company paid the Management Company a management fee of 5% and a partnership management fee of 1% based on Effective Gross Revenues from the properties, as defined. After September 1, 2004, the Company pays the Management Company management fees in an amount not to exceed the fees customarily charged in arm's length transactions by others rendering similar services in the same geographic area, as determined by a survey of brokers and agents in such area. The Company expects these fees to be between approximately 2% and 4% of Gross Revenues, as such term is defined in the amended and restated property management agreement, for the management of commercial office buildings and approximately 5% of Gross Revenues for the management of retail and industrial properties. Effective September 1, 2004, the Company entered into an advisory agreement with the Management Company which provides that the Company pay the Management Company a fee of one-fourth of .25% of Gross Asset Value, as such term is defined in the advisory agreement, per quarter for asset management services. The Company incurred total management, partnership and asset management fees of \$1,339,822, \$1,232,127 and \$1,231,212 for the years ended December 31, 2004, 2003 and 2002, respectively, of which \$54,331 and \$93,006 were payable at December 31, 2004 and 2003, respectively.

During July 2004, the Company amended certain terms of its Declaration of Trust. Under the amended terms, the Management Company may be required to reimburse the Company for operating expenses exceeding certain limitations determined at the end of each fiscal quarter. Reimbursements, if any, from the Management Company are recorded on a quarterly basis as a reduction in management fees.

Under the provisions of the property management agreements, costs incurred by the Management Company for the management and maintenance of the properties are reimbursable to the Management Company. At December 31, 2004 and 2003, \$188,772 and \$288,305, respectively, was payable to the Management Company related to these reimbursable costs.

In consideration of leasing the properties, the Company also pays the Management Company leasing commissions of 6% for leases originated by the Management Company and 4% for expansions and renewals of existing leases based on Effective Gross Revenues from the

**Hartman Commercial Properties REIT and Subsidiary**

**Notes to Consolidated Financial Statements**

**December 31, 2004**

**Note 10 Related-Party Transactions (Continued)**

properties. The Company incurred total leasing commissions to the Management Company of \$952,756, \$978,398 and \$890,852 for the years ended December 31, 2004, 2003 and 2002, respectively, of which \$232,343 and \$175,725 were payable at December 31, 2004 and 2003, respectively.

The fees payable to the Management Company under the new agreements effective September 1, 2004 were not significantly different from those that would have been payable under the previous agreement.

In connection with the Public Offering described in Note 11, the Company reimburses the Management Company up to 2.5% of the gross selling price of all common shares sold for organization and offering expenses (excluding selling commissions and a dealer manager fee) incurred by the Management Company on behalf of the Company. No such reimbursable expenses were incurred for the year ended December 31, 2004 because the Company had not received the minimum subscription proceeds required to break escrow.

Also in connection with the Public Offering described in Note 11, the Management Company also receives an acquisition fee equal to 2% of the gross selling price of all common shares sold for services in connection with the selection, purchase, development or construction of properties for the Company. No such fees were incurred for the year ended December 31, 2004 because the Company had not received the minimum subscription proceeds required to break escrow.

In connection with the Private Offering as described in Note 11, the Company paid the Management Company a fee of up to 2% of the gross selling price of all common shares sold in consideration of offering services performed by the Management Company. The Company incurred total fees of \$3,259 for the year ended December 31, 2002. Such fees have been treated as offering costs and netted against the proceeds from the sale of common shares.

Also in connection with the Private Offering as described in Note 11, the Management Company received an acquisition fee equal to 4% of the gross selling price of all common shares sold as a reimbursement of expenses incurred in identifying reviewing, and acquiring properties for the Company. The Company incurred total fees of \$6,766 for the year ended December 31, 2002. Such fees have been treated as offering costs and netted against the proceeds from the sale of common shares.

The Management Company paid the Company \$106,824, \$106,789 and \$79,168 for office space in 2004, 2003 and 2002, respectively. Such amounts are included in rental income in the consolidated statements of income.

In conjunction with the acquisition of certain properties, the Company assumed liabilities payable to the Management Company. At December 31, 2004 and 2003, \$200,415 was payable to the Management Company related to these liabilities.

HCP's day-to-day operations are strategically directed by the Board of Trustees and implemented through the Management Company. Hartman is HCP's Board Chairman and sole owner of the Management Company. Hartman was owed \$47,386 and \$41,306 in dividends payable on his common shares at December 31, 2004 and 2003, respectively. Hartman owned 3.9%, 3.4% and 3.4% of the issued and outstanding common shares of the Company as of December 31, 2004, 2003 and 2002, respectively.

The Company was a party to various other transactions with related parties which are reflected in due to/from affiliates in the accompanying consolidated balance sheets and also disclosed in Notes 2, 7 and 11.

**Hartman Commercial Properties REIT and Subsidiary**

**Notes to Consolidated Financial Statements**

**December 31, 2004**

**Note 11 Shareholders' Equity**

In July 2004, HCP changed its state of organization from Texas to Maryland pursuant to a merger of HCP directly with and into a Maryland real estate investment trust formed for the sole purpose of the reorganization and the conversion of each outstanding common share of beneficial interest of the Texas entity into 1.42857 common shares of beneficial interest of the Maryland entity. Under its Articles of Amendment and Restatement in effect, HCP has authority to issue 400,000,000 common shares of beneficial interest, \$0.001 par value per share, and 50,000,000 preferred shares of beneficial interest, \$0.001 par value per share. All capital stock amounts, share and per share information in the accompanying consolidated financial statements and the related notes to consolidated financial statements have been adjusted to retroactively reflect this recapitalization.

Prior to June 2004, the Charter and Bylaws of HCP authorized HCP to issue up to 100,000,000 common shares at \$0.001 par value per share, and 10,000,000 Preferred Shares at \$0.001 par value per share. HCP commenced a private offering (the "Private Offering") in May 1999 to sell 2,500,000 common shares, par value \$0.001 per share, at a price of \$10 per common share for a total Private Offering of \$25,000,000. HCP intended that the Private Offering be exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Regulation D promulgated thereunder. The common shares are "restricted securities" and are not transferable unless they subsequently are registered under the 1933 Act and applicable state securities laws or an exemption from such registration is available. The Private Offering was directed solely to "accredited investors" as such term is defined in Regulation D. Pursuant to the Private Offering, HCP sold for cash or issued in exchange for property or OP Units, 4,907,107 (7,010,146 after the reorganization) shares as of December 31, 2004, 2003 and 2002. HCP conducts substantially all of its operations through the Operating Partnership. All net proceeds of the Private Offering were contributed by HCP to the Operating Partnership in exchange for OP Units. The Operating Partnership used the proceeds to acquire additional commercial properties and for general working capital purposes. HCP received one OP Unit for each \$10 contributed to the Operating Partnership. OP Units were valued at \$10 per unit because they are convertible on a one-for-one basis to common shares which were being sold in the Private Offering for \$10 per common share.

On September 15, 2004, HCP's Registration Statement on Form S-11, with respect to a public offering (the "Public Offering") of up to 10,000,000 common shares of beneficial interest to be offered at a price of \$10 per share was declared effective under the Securities Act of 1933. The Registration Statement also covers up to 1,000,000 shares available pursuant to HCP's dividend reinvestment plan to be offered at a price of \$9.50 per share. The shares are offered to investors on a best efforts basis.

As of December 31, 2004, no shares had been issued pursuant to the Public Offering. HCP will not admit new shareholders pursuant to the Public Offering or receive proceeds from the Public Offering until it receives and accepts subscriptions for a minimum of 200,000 shares for gross offering proceeds of \$2,000,000. As of December 31, 2004, HCP had received and accepted subscriptions for 147,432 shares for gross offering proceeds of \$1,474,320. After the initial 200,000 shares are sold, subscription proceeds will be held in escrow until investors are admitted as shareholders. HCP intends to admit new stockholders at least monthly. At that time, subscription proceeds may be released to HCP from escrow and applied to the making of investments and the payment or reimbursement of the dealer manager fee, selling commissions and other organization and offering expenses. Until required for such purposes, net offering proceeds will be held in short-term, liquid investments.

As of February 11, 2005, 277,775 shares had been issued pursuant to the Public Offering with gross offering proceeds received of \$2,777,750.

At December 31, 2004, Hartman and the Board of Trustees collectively owned 8.22% of HCP's outstanding shares.

## Hartman Commercial Properties REIT and Subsidiary

## Notes to Consolidated Financial Statements

December 31, 2004

## Note 11 Shareholders' Equity (Continued)

*Operating Partnership units*

Limited partners in the Operating Partnership holding OP Units have the right to convert their OP Units into common shares at a ratio of one OP Unit for one common share. In connection with the reorganization discussed above, OP Unit holders received 1.42857 OP Units for each OP Unit previously held. Subject to certain restrictions, OP Units are not convertible into common shares until the later of one year after acquisition or an initial public offering of the common shares. As of December 31, 2004 and 2003, after giving effect to the recapitalization, there were 12,456,995 OP Units outstanding. HCP owned 6,648,658 Units as of December 31, 2004 and 2003. HCP's weighted-average share ownership in the Operating Partnership was approximately 53.37%, 53.37% and 53.71% during the years ended December 31, 2004, 2003 and 2002, respectively. At December 31, 2004, Hartman and the Board of Trustees collectively owned 9.50% of the Operating Partnership's outstanding units.

During 2002, the Company acquired ten properties from various Hartman operated limited partnerships in exchange for 2,851,066 (4,072,947 after giving effect to the recapitalization) OP Units valued at \$10 per unit at the time of the acquisition (see Note 2).

*Dividends and distributions*

The following tables summarize the cash dividends/distributions payable to holders of common shares and holders of OP Units (after giving effect to the recapitalization) related to the years ended December 31, 2004, 2003 and 2002.

## HCP Shareholders

Dividend/Distribution per Common Share	Date Dividend Payable	Total Amount Payable
\$ 0.1575	5/15/02	\$ 1,102,340
0.16625	8/15/02	1,166,709
0.1750	11/15/02	1,226,777
0.1750	2/15/03	1,226,777
0.0583	4/15/03	408,762
0.0583	5/15/03	408,762
0.0584	6/15/03	409,253
0.0583	7/15/03	408,762
0.0583	8/15/03	408,762
0.0584	9/15/03	409,253
0.0583	10/15/03	408,762
0.0583	11/15/03	408,762
0.0584	12/15/03	409,253
0.0583	1/15/04	408,762
0.0583	2/15/04	408,762
0.0584	3/15/04	409,253
0.0583	4/15/04	408,762
0.0583	5/15/04	408,762
0.0584	6/15/04	409,253
0.0583	7/15/04	408,762
0.0583	8/15/04	408,762
0.0584	9/15/04	409,253
0.0583	10/15/04	408,692
0.0583	11/15/04	408,692
0.0584	12/15/04	409,392
0.0583	1/15/05	408,692
0.0583	2/15/05	408,692

**HCP Shareholders**

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0.0589

3/15/05  
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412,897

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## Hartman Commercial Properties REIT and Subsidiary

## Notes to Consolidated Financial Statements

December 31, 2004

## Note 11 Shareholders' Equity (Continued)

*Dividends and distributions (continued)*

## OP Unit Holders Including Minority Unit Holders

Dividend/Distribution per OP Unit	Date Dividend Payable	Total Amount Payable
\$ 0.1575	5/15/02	\$ 1,942,412
0.16625	8/15/02	2,053,866
0.1750	11/15/02	2,161,143
0.1750	2/15/03	2,179,976
0.0583	4/15/03	726,368
0.0583	5/15/03	726,368
0.0584	6/15/03	727,240
0.0583	7/15/03	726,368
0.0583	8/15/03	726,368
0.0584	9/15/03	727,240
0.0583	10/15/03	726,368
0.0583	11/15/03	726,368
0.0584	12/15/03	727,240
0.0583	1/15/04	726,368
0.0583	2/15/04	726,368
0.0584	3/15/04	727,240
0.0583	4/15/04	726,368
0.0583	5/15/04	726,368
0.0584	6/15/04	727,240
0.0583	7/15/04	726,368
0.0583	8/15/04	726,368
0.0584	9/15/04	727,240
0.0583	10/15/04	726,243
0.0583	11/15/04	726,243
0.0584	12/15/04	727,488
0.0583	1/15/05	726,243
0.0583	2/15/05	726,243
0.0589	3/15/05	733,717

## Note 12 Incentive Share Plan

The Company has adopted an Employee and Trust Manager Incentive Share Plan (the "Incentive Share Plan") to (i) furnish incentives to individuals chosen to receive share-based awards because they are considered capable of improving operations and increasing profits; (ii) encourage selected persons to accept or continue employment with the Company; and (iii) increase the interest of employees and Trustees in the Company's welfare through their participation and influence on the growth in value of the common shares. The class of eligible persons that can receive grants of incentive awards under the Incentive Share Plan consists of key employees, directors, non-employee trustees, members of the Management Company and consultants as determined by the compensation committee of the Board of Trustees. The total number of common shares that may be issued under the Incentive Share Plan is an amount of shares equal to 5% of the outstanding shares on a fully diluted basis. As of December 31, 2004, no options or awards to purchase common shares have been granted under the Incentive Share Plan.

**Hartman Commercial Properties REIT and Subsidiary**

**Notes to Consolidated Financial Statements**

**December 31, 2004**

**Note 12 Incentive Share Plan (Continued)**

Under SFAS No. 123, "*Accounting for Stock Based Compensation*", and SFAS No. 148, "*Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123*", the Company is permitted to either record compensation expense for incentive awards granted to employees and directors based on their fair value on the date of grant or to apply the intrinsic value method prescribed in Accounting Principles Board ("APB") Opinion No. 25, "*Accounting for Stock Issued to Employees*", and recognize compensation expense, if any, to the extent that the fair market value of the underlying stock on the grant date exceeds the exercise price of the award granted. Compensation expense for awards granted to employees and directors is currently based on the intrinsic value method. For awards granted to non-employees, such as Trustees, employees of the Management Company, and consultants, the Company currently records expense based on the award's fair value on its date of grant as required by SFAS 123 and SFAS 148.

**Note 13 Commitments and Contingencies**

The Company is a participant in various legal proceedings and claims that arise in the ordinary course of business. These matters are generally covered by insurance. While the resolution of these matters cannot be predicted with certainty, the Company believes that the final outcome of such matters will not have a material effect on the financial position, results of operations, or cash flows of the Company.

**Note 14 Segment Information**

The operating segments presented are the segments of the Company for which separate financial information is available, and operating performance is evaluated regularly by senior management in deciding how to allocate resources and in assessing performance. The Company evaluated the performance of its operating segments based on net operating income that is defined as total revenues less operating expenses and ad valorem taxes. Management does not consider gains or losses from the sale of property in evaluating ongoing operating performance.

The retail segment is engaged in the acquisition, development and management of real estate, primarily anchored neighborhood and community shopping centers located in the Houston and San Antonio, Texas metropolitan areas. The customer base includes supermarkets and other retailers who generally sell basic necessity-type commodities. The office/warehouse segment is engaged in the acquisition, development and management of office and warehouse centers located in the Houston, Texas metropolitan area and has a diverse customer base. The office segment is engaged in the acquisition, development and management of commercial office space. Included in "Other" are corporate related items, insignificant operations and costs that are not allocated to the reportable segments.

## Hartman Commercial Properties REIT and Subsidiary

## Notes to Consolidated Financial Statements

December 31, 2004

## Note 14 Segment Information (Continued)

Information concerning the Company's reportable segments for the years ended December 31 is as follows:

	<u>Retail</u>	<u>Office/ Warehouse</u>	<u>Office</u>	<u>Other</u>	<u>Total</u>
<b>2004</b>					
Revenues	\$ 12,767,273	\$ 8,678,627	\$ 1,660,401	\$ 377,356	\$ 23,483,657
Segment operating income	8,736,254	5,476,672	877,505	350,215	15,440,646
Total assets	74,979,000	49,389,486	7,154,937	11,093,517	142,616,940
Capital expenditures	9,653,652	589,791	33,553		10,276,996
<b>2003</b>					
Revenues	\$ 10,747,435	\$ 8,399,522	\$ 1,552,976	\$ 273,018	\$ 20,972,951
Segment operating income	7,082,260	5,508,082	835,171	230,297	13,655,810
Total assets	66,467,920	50,107,322	7,329,468	10,161,681	134,066,391
Capital expenditures	14,065,370	598,583	27,545		14,691,498
<b>2002</b>					
Revenues	\$ 10,851,942	\$ 8,282,170	\$ 1,558,335	\$ 62,579	\$ 20,755,026
Segment operating income	7,200,296	5,361,944	759,761	22,528	13,344,529
Total assets	54,300,713	50,685,602	7,628,230	14,349,231	126,963,776
Capital expenditures	17,005,552	29,411,594	158,046		46,575,192

Net operating income reconciles to net income shown on the consolidated statements of income for the years ended December 31 as follows:

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Total segment operating income	\$ 15,440,646	\$ 13,655,810	\$ 13,344,529
Less:			
Depreciation and amortization	5,223,422	4,758,047	4,041,861
Interest	2,664,135	1,323,378	1,573,270
General and administrative	1,139,060	1,065,416	831,675
Income before minority interests	6,414,029	6,508,969	6,897,723
Minority interests in Operating Partnership	(2,990,410)	(3,034,795)	(3,192,605)
Net income	\$ 3,423,619	\$ 3,474,174	\$ 3,705,118

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## Hartman Commercial Properties REIT and Subsidiary

## Notes to Consolidated Financial Statements

December 31, 2004

**Note 15 Pro Forma Financial Information (Unaudited)**

During December 2003 the Company acquired a retail center for approximately \$13,100,000. The pro forma financial information for the years ended December 31, 2003 and 2002 is based on the historical statements of the Company after giving effect to the acquisition as if such acquisition took place on January 1, 2002.

The pro forma financial information shown below is presented for information purposes only and may not be indicative of results that would have actually occurred if the acquisition had been in effect at the date indicated, nor does it purport to be indicative of the results that may be achieved in the future.

	Year Ended December 31,	
	2003	2002
Pro forma revenues	\$ 23,082,293	\$ 22,716,091
Pro forma net income available to common shareholders	\$ 3,694,840	\$ 3,810,058
Pro forma basic and diluted earnings per common share	\$ 0.527	\$ 0.544

**Note 16 Selected Quarterly Financial Data (Unaudited)**

The following is a summary of the unaudited quarterly financial information for the years ended December 31, 2004 and 2003:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>2004</b>				
Revenues	\$ 5,486,426	\$ 6,095,742	\$ 5,922,856	\$ 5,978,633
Income before minority interests	1,384,807	1,792,127	1,493,760	1,743,335
Minority interest in income	(645,689)	(835,606)	(696,464)	(812,651)
Net income	739,118	956,521	797,296	930,684
Basic and diluted earnings per share	\$ 0.105	\$ 0.136	\$ 0.114	\$ 0.133
<b>2003</b>				
Revenues	\$ 5,537,139	\$ 5,485,617	\$ 5,034,083	\$ 4,916,112
Income before minority interests	1,704,364	1,967,161	1,447,357	1,390,087
Minority interest in income	(794,662)	(917,156)	(676,661)	(646,316)
Net income	909,702	1,050,005	770,696	743,771
Basic and diluted earnings per share	\$ 0.130	\$ 0.150	\$ 0.110	\$ 0.106

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**Hartman Commercial Properties REIT and Subsidiary  
Schedule II Valuation and Qualifying Accounts**

Description	Balance at Beginning of Period	Additions Charged (Recoveries Credited) to Expense	Deductions	Additions Related to Acquired Assets	Balance at End of Period
Allowance for doubtful accounts:					
Year ended December 31, 2004	\$ 350,750	\$ (8,060)	\$	\$	\$ 342,690
Year ended December 31, 2003	391,500	213,250	(254,000)		350,750
Year ended December 31, 2002	225,800	74,200		91,500	391,500
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**Hartman Commercial Properties REIT and Subsidiary**  
**Schedule III Real Estate and Accumulated Depreciation**  
**December 31, 2004**

Name	Description	Initial Cost		Costs Capitalized Subsequent to Acquisition		Gross Amount at which Carried at End of Period(1)(2)		Total
		Land	Building and Improvements	Improvements	Carrying Costs	Land	Building and Improvements	
Holly Knight	Retail	\$ 319,981	\$ 1,292,820	\$ 30,128		\$ 319,981	\$ 1,322,948	\$ 1,642,929
Kempwood Plaza	Retail	733,443	1,798,433	785,159		733,443	2,583,592	3,317,035
Bissonnet Beltway	Retail	414,515	1,946,808	155,025		414,515	2,101,833	2,516,348
Interstate 10	Office/warehouse	207,903	3,700,169	233,368		207,903	3,933,537	4,141,440
West Belt Plaza	Office/warehouse	567,805	2,165,204	271,015		567,805	2,436,219	3,004,024
Greens Road	Retail	353,604	1,283,613	81,921		353,604	1,365,534	1,719,138
Town Park	Retail	849,529	2,911,206	153,305		849,529	3,064,511	3,914,040
Webster Point	Retail	720,336	1,150,029	74,089		720,336	1,224,118	1,944,454
Centre South	Retail	481,201	1,595,997	386,964		481,201	1,982,961	2,464,162
Torrey Square	Retail	1,981,406	2,970,911	329,447		1,981,406	3,300,358	5,281,764
Dairy Ashford	Office/warehouse	225,544	1,211,476	90,855		225,544	1,302,331	1,527,875
Main Park	Office/warehouse	1,327,762	2,721,075	458,107		1,327,762	3,179,182	4,506,944
Northeast Square	Retail	564,927	2,007,585	215,914		564,927	2,223,499	2,788,426
Plaza Park	Office/warehouse	901,602	3,293,514	215,065		901,602	3,508,579	4,410,181
Northwest Place	Office/warehouse	110,790	978,554	21,970		110,790	1,000,524	1,111,314
Lion Square	Retail	1,546,010	4,289,098	262,337		1,546,010	4,551,435	6,097,445
Zeta Building	Office	637,180	1,819,409	102,983		637,180	1,922,392	2,559,572
Royal Crest	Office	508,850	1,355,215	123,532		508,850	1,478,747	1,987,597
Featherwood	Office	368,283	2,591,026	419,156		368,283	3,010,182	3,378,465
South Richey	Retail	777,720	2,584,167	218,447		777,720	2,802,614	3,580,334
Corporate Park								
Woodland	Office/warehouse	651,549	5,376,813	492,876		651,549	5,869,689	6,521,238
South Shaver	Retail	184,368	632,635	190,061		184,368	822,696	1,007,064
Providence	Retail	917,936	3,674,732	226,222		917,936	3,900,954	4,818,890
Corporate Park								
Northwest	Office/warehouse	1,533,940	6,305,599	340,628		1,533,940	6,646,227	8,180,167
Bellnot Square	Retail	1,154,239	4,638,055	40,028		1,154,239	4,678,083	5,832,322
Corporate Park								
West	Office/warehouse	2,555,289	10,507,691	228,453		2,555,289	10,736,144	13,291,433
Westgate	Office/warehouse	672,303	2,775,879	98,920		672,303	2,874,799	3,547,102
Garden Oaks	Retail	1,285,027	5,292,755	173,459		1,285,027	5,466,214	6,751,241
Westchase	Retail	422,745	1,750,555	199,784		422,745	1,950,339	2,373,084
Sunridge	Retail	275,534	1,186,037	33,821		275,534	1,219,858	1,495,392
Holly Hall	Office/warehouse	607,519	2,515,881	18,403		607,519	2,534,284	3,141,803
Brookhill	Office/warehouse	185,659	787,605	162,279		185,659	949,884	1,135,543
Windsor Park	Retail	2,620,500	10,482,000			2,620,500	10,482,000	13,102,500
Stafford Plaza	Retail	1,781,211	7,124,846	307		1,781,211	7,125,153	8,906,364
<b>TOTAL</b>		<b>\$ 28,446,210</b>	<b>\$ 106,717,392</b>	<b>\$ 6,834,028</b>	<b>\$</b>	<b>\$ 28,446,210</b>	<b>\$ 113,551,420</b>	<b>\$ 141,997,630</b>

**Hartman Commercial Properties REIT and Subsidiary**  
**Schedule III Real Estate and Accumulated Depreciation**  
**December 31, 2004**  
**(Continued)**

Name	Description	Accumulated Depreciation	Date of Construction	Date Acquired	Depreciation Life
Holly Knight	Retail	\$ 261,758		8/1/00	5-39 years
Kempwood Plaza	Retail	603,144		2/2/99	5-39 years
Bissonnet Beltway	Retail	495,378		1/1/99	5-39 years
Interstate 10	Office/warehouse	962,309		1/1/99	5-39 years
West Belt Plaza	Office/warehouse	618,554		1/1/99	5-39 years
Greens Road	Retail	303,295		1/1/99	5-39 years
Town Park	Retail	682,895		1/1/99	5-39 years
Webster Point	Retail	226,933		1/1/00	5-39 years
Centre South	Retail	402,012		1/1/00	5-39 years
Torrey Square	Retail	528,529		1/1/00	5-39 years
Dairy Ashford	Office/warehouse	281,205		1/1/99	5-39 years
Main Park	Office/warehouse	741,772		1/1/99	5-39 years
Northeast Square	Retail	436,357		1/1/99	5-39 years
Plaza Park	Office/warehouse	615,354		1/1/00	5-39 years
Northwest Place	Office/warehouse	160,715		1/1/00	5-39 years