

AGREE REALTY CORP
Form 10-Q
May 10, 2010

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

FORM 10-Q

Mark One

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2010

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 1-12928

Agree Realty Corporation

(Exact name of registrant as specified in its charter)

Maryland 38-3148187
(State or other jurisdiction (I.R.S. Employer
of incorporation or organization) Identification No.)

31850 Northwestern Highway, Farmington Hills, Michigan 48334
(Address of principal executive offices) (Zip code)

Registrant's telephone number, including area code: (248) 737-4190

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Agree Realty Corporation

Form 10-Q

Index

Page

| | | |
|----------|---|-------|
| Part I: | Financial Information | |
| Item 1. | Interim Consolidated Financial Statements | |
| | Consolidated Balance Sheets as of March 31, 2010 (Unaudited) and December 31, 2009 | 1-2 |
| | Consolidated Statements of Income (Unaudited) for the three months ended March 31, 2010 and 2009 | 3 |
| | Consolidated Statements of Stockholders' Equity (Unaudited) for the three months ended March 31, 2010 | 4 |
| | Consolidated Statements of Cash Flows (Unaudited) for the three months ended March 31, 2010 and 2009 | 5-6 |
| | Notes to Consolidated Financial Statements (Unaudited) | 7-11 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 12-17 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 17-18 |
| Item 4. | Controls and Procedures | 18 |
| Part II: | Other Information | |
| Item 1. | Legal Proceedings | 18 |
| Item 1A. | Risk Factors | 18 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 18 |
| Item 3. | Defaults Upon Senior Securities | 19 |
| Item 4. | {Removed and Reserved} | 19 |
| Item 5. | Other Information | 19 |
| Item 6. | Exhibits | 19 |
| | Signatures | 20 |

Agree Realty Corporation

Consolidated Balance Sheets

| | March 31 2010 (Unaudited) | December 31, 2009 |
|--|---------------------------------|-----------------------|
| Assets | | |
| Real Estate Investments | | |
| Land | \$ 92,692,037 | \$ 95,047,459 |
| Buildings | 217,626,796 | 220,604,734 |
| Property under development | 5,200,831 | 4,791,975 |
| | 315,519,664 | 320,444,168 |
| Less accumulated depreciation | (64,311,743) | (64,076,469) |
| Net Real Estate Investments | 251,207,921 | 256,367,699 |
| Cash and Cash Equivalents | 565,298 | 688,675 |
| Cash – Restricted | 9,772,416 | - |
| Accounts Receivable - Tenants, net of allowance of \$35,000 at March 31, 2010 and December 31, 2009 | 2,650,539 | 1,986,836 |
| Unamortized Deferred Expenses | | |
| Financing costs, net of accumulated amortization of \$5,192,918 and \$5,126,333 at March 31, 2010 and December 31, 2009 | 1,294,578 | 1,360,514 |
| Leasing costs, net of accumulated amortization of \$860,454 and \$841,427 at March 31, 2010 and December 31, 2009 | 569,423 | 537,100 |
| Other Assets | 892,463 | 847,894 |
| | \$ 266,952,638 | \$ 261,788,718 |

See accompanying notes to consolidated financial statements.

Agree Realty Corporation

Consolidated Balance Sheets

| | March 31, 2010 (Unaudited) | December 31, 2009 |
|---|----------------------------------|-----------------------|
| Liabilities and Stockholders' Equity | | |
| Mortgages Payable | \$ 74,570,943 | \$ 75,552,802 |
| Notes Payable | 29,797,500 | 29,000,000 |
| Dividends and Distributions Payable | 4,375,999 | 4,354,163 |
| Deferred Revenue | 9,862,917 | 10,035,304 |
| Accrued Interest Payable | 260,106 | 261,012 |
| Accounts Payable | | |
| Capital expenditures | 438,749 | 352,430 |
| Operating | 1,089,295 | 1,529,085 |
| Interest Rate Swap | 370,547 | 74,753 |
| Deferred Income Taxes | 705,000 | 705,000 |
| Tenant Deposits | 91,820 | 97,285 |
| Total Liabilities | 121,562,876 | 121,961,834 |
| Stockholders' Equity | | |
| Common stock, \$0.0001 par value; 13,350,000 shares authorized, 8,252,014 and 8,196,074 shares issued and outstanding | 825 | 820 |
| Excess stock, \$0.0001 par value, 6,500,000 shares authorized, 0 shares issued and outstanding | — | — |
| Series A junior participating preferred stock, \$0.0001 par value, 150,000 shares authorized, 0 shares issued and outstanding | — | — |
| Additional paid-in capital | 147,742,101 | 147,466,101 |
| Deficit | (5,275,237) | (10,632,798) |
| Accumulated other comprehensive income (loss) | (355,577) | (70,806) |
| Total stockholders' equity—Agree Realty Corporation | 142,112,112 | 136,763,317 |
| Non-controlling interest | 3,277,650 | 3,063,567 |
| Total Stockholders' Equity | 145,389,762 | 139,826,884 |
| | \$ 266,952,638 | \$ 261,788,718 |

See accompanying notes to consolidated financial statements.

Agree Realty Corporation

Consolidated Statements of Income (Unaudited)

| | Three Months Ended | | Three Months Ended | |
|--|--------------------|------------------|--------------------|------------------|
| | March 31, 2010 | | March 31, 2009 | |
| Revenues | | | | |
| Minimum rents | \$ | 8,437,272 | \$ | 8,331,333 |
| Percentage rents | | 465 | | 6,995 |
| Operating cost reimbursements | | 669,815 | | 718,623 |
| Development fee income | | 397,009 | | - |
| Other income | | 17,771 | | 3,761 |
| Total Revenues | | 9,522,332 | | 9,060,712 |
| Operating Expenses | | | | |
| Real estate taxes | | 489,362 | | 478,941 |
| Property operating expenses | | 395,680 | | 457,787 |
| Land lease payments | | 226,575 | | 214,800 |
| General and administrative | | 1,251,729 | | 1,251,290 |
| Depreciation and amortization | | 1,431,727 | | 1,394,498 |
| Total Operating Expenses | | 3,795,073 | | 3,797,316 |
| Income From Operations | | 5,727,259 | | 5,263,396 |
| Other Expense | | | | |
| Interest expense, net | | (1,269,757) | | (1,125,624) |
| Income Before Discontinued Operations | | 4,457,502 | | 4,137,772 |
| Gain on sale of asset from discontinued operations | | 5,331,685 | | - |
| Income from discontinued operations | | 179,293 | | 179,293 |
| Net Income | | 9,968,480 | | 4,317,065 |
| Less Net Income Attributable to Non-Controlling Interest | | (402,392) | | (306,419) |
| Net Income Attributable to Agree Realty Corporation | \$ | 9,566,088 | \$ | 4,010,646 |
| Earnings Per Share – Basic | \$ | 1.18 | \$ | 0.52 |
| Earnings Per Share – Dilutive | \$ | 1.18 | \$ | 0.52 |
| Dividend Declared Per Share | \$ | 0.51 | \$ | 0.50 |
| Weighted Average Number of Common Shares Outstanding – Basic | | 8,096,615 | | 7,774,640 |
| Weighted Average Number of Common Shares Outstanding – Dilutive | | 8,130,290 | | 7,781,740 |

See accompanying notes to consolidated financial statements.

Agree Realty Corporation

Consolidated Statement of Stockholders' Equity (Unaudited)

| | Common Stock Shares | Common Stock Amount | Additional Paid-In Capital | Non-Controlling Interest | Deficit | Accumulated Other Comprehensive Income (loss) |
|---|------------------------|------------------------|----------------------------------|-----------------------------|-----------------|--|
| Balance, January 1, 2010 | 8,196,074 | \$ 820 | \$ 147,466,101 | \$ 3,063,567 | \$ (10,632,798) | \$ (70,806) |
| Issuance of shares under the Equity Incentive Plan | 76,550 | 8 | — | — | — | — |
| Forfeiture of shares | (20,610) | (3) | — | — | — | — |
| Vesting of restricted stock | — | — | 276,000 | — | — | — |
| D i v i d e n d s a n d distributions declared for the period January 1, 2010 to March 31, 2010 | — | — | — | (177,286) | (4,208,527) | — |
| Other comprehensive (loss) | — | — | — | (11,023) | — | (284,771) |
| Net income for the period January 1, 2010 to March 31, 2010 | — | — | — | 402,392 | 9,566,088 | — |
| Balance, March 31, 2010 | 8,252,014 | \$ 825 | \$ 147,742,101 | \$ 3,277,650 | \$ (5,275,237) | \$ (355,577) |

See accompanying notes to consolidated financial statements.

Agree Realty Corporation

Consolidated Statements of Cash Flows (Unaudited)

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|--|--------------------------------------|--------------------------------------|
| Cash Flows From Operating Activities | | |
| Net income | \$ 9,968,480 | \$ 4,317,065 |
| Adjustments to reconcile net income to net cash provided by operating Activities | | |
| Depreciation | 1,412,700 | 1,378,475 |
| Amortization | 85,612 | 85,443 |
| Stock-based compensation | 276,000 | 292,000 |
| Gain on sale of asset | (5,331,685) | - |
| (Increase) decrease in accounts receivable | (663,703) | 88,341 |
| (Increase) decrease in other assets | (56,478) | 27,880 |
| Decrease in accounts payable | (439,790) | (306,453) |
| Decrease in deferred revenue | (172,387) | (172,387) |
| (Decrease) in accrued interest | (906) | (254,030) |
| (Decrease) in tenant deposits | (5,465) | - |
| Net Cash Provided By Operating Activities | 5,072,378 | 5,456,334 |
| Cash Flows From Investing Activities | | |
| Acquisition of real estate investments (including capitalized interest of \$49,255 in 2010 and \$76,273 in 2009) | (235,377) | (1,241,563) |
| Net proceeds from sale of assets, less amounts held in restricted escrow | (7,613) | - |
| Net Cash Used In Investing Activities | (242,990) | (1,241,563) |
| Cash Flows From Financing Activities | | |
| Payments of mortgages payable | (981,859) | (828,267) |
| Dividends and limited partners' distributions paid | (4,363,977) | (4,250,468) |
| Line-of-credit net borrowings (repayments) | 797,500 | 1,560,000 |
| Repayments of capital expenditure payables | (352,430) | (850,225) |
| Payments of financing costs | (649) | (177,199) |
| Payments of leasing costs | (51,350) | (75,000) |
| Net Cash Used In Financing Activities | (4,952,765) | (4,621,159) |
| Net Decrease In Cash and Cash Equivalents | (123,377) | (406,388) |
| Cash and Cash Equivalents, beginning of period | 688,675 | 668,677 |
| Cash and Cash Equivalents, end of period | \$ 565,298 | \$ 262,289 |

Agree Realty Corporation

Consolidated Statements of Cash Flows (Unaudited)

| | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2009 |
|---|--------------------------------------|--------------------------------------|
| Supplemental Disclosure of Cash Flow Information | | |
| Cash paid for interest (net of amounts capitalized) | \$ 1,204,078 | \$ 1,310,234 |
| Supplemental Disclosure of Non-Cash Transactions | | |
| Dividends and limited partners' distributions declared and unpaid | \$ 4,375,999 | \$ 4,250,979 |
| Real estate investments financed with accounts payable | \$ 438,749 | \$ 617,631 |

See accompanying notes to consolidated financial statements.

1. **Basis of Presentation** The accompanying unaudited consolidated financial statements of Agree Realty Corporation (the “Company”) for the three months ended March 31, 2010 have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for audited financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The consolidated balance sheet at December 31, 2009 has been derived from the audited consolidated financial statements at that date. Operating results for the three months ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010 or for any other interim period. For further information, refer to the audited consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2009.

We have evaluated subsequent events since March 31, 2010 for events requiring recording or disclosure in this quarterly report on Form 10-Q.

2. **Stock Based Compensation** The Company estimates the fair value of restricted stock and stock option grants at the date of grant and amortizes those amounts into expense on a straight line basis or amount vested, if greater, over the appropriate vesting period.

As of March 31, 2010, there was \$3,442,346 unrecognized compensation costs related to the outstanding restricted shares, which is expected to be recognized over a weighted average period of 3.77 years. The Company used a 0% discount factor and forfeiture rate for determining the fair value of restricted stock. The forfeiture rate was based on historical results and trends.

The holder of a restricted share award is generally entitled at all times on and after the date of issuance of the restricted shares to exercise the rights of a stockholder of the Company, including the right to vote the shares and the right to receive dividends on the shares.

| | Shares Outstanding | Weighted Average Grant Date Fair Value |
|---|-----------------------|---|
| Unvested restricted shares at January 1, 2010 | 140,980 | \$ 22.40 |
| Restricted shares granted | 76,550 | 22.52 |
| Restricted shares vested | (30,600) | 22.60 |
| Restricted shares forfeited | (20,610) | 16.88 |
| Unvested restricted shares at March 31, 2010 | 166,320 | \$ 22.40 |

Agree Realty Corporation

3. Earnings Per Share Earnings per share has been computed by dividing the net income attributable to Agree Realty Corporation by the weighted average number of common shares outstanding.

The following is a reconciliation of the denominator of the basic net earnings per common share computation to the denominator of the diluted net earnings per common share computation for each of the periods presented:

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2010 | 2009 |
| Weighted average number of common shares outstanding | 8,264,495 | 7,924,320 |
| Unvested restricted stock | (167,880) | (149,680) |
| Weighted average number of common shares outstanding used in basic earnings per share | 8,096,615 | 7,774,640 |
| Weighted average number of common shares outstanding used in basic earnings per share | 8,096,615 | 7,774,640 |
| Effect of dilutive securities: | | |
| Restricted stock | 33,675 | 7,100 |
| Common stock options | — | — |
| Weighted average number of common shares outstanding used in diluted earnings per share | 8,130,290 | 7,781,740 |

4. Subsequent Event On April 16, 2010, we completed a secondary offering of 1,495,000 shares of common stock. The offering, which included the exercise of the over-allotment option by the underwriter, raised approximately \$31.1 million. The proceeds from the offering were used to pay down amounts outstanding under our credit facilities.

5. **Derivative Instruments and Hedging Activity** On January 2, 2009, the Company entered into an interest rate swap agreement for a notional amount of \$24,501,280, effective on January 2, 2009 and ending on July 1, 2013. The notional amount decreases over the term to match the outstanding balance of the hedged borrowing. The Company entered into this derivative instrument to hedge against the risk of changes in future cash flows related to changes in interest rates on \$24,501,280 of the total variable-rate borrowings outstanding. Under the terms of the interest rate swap agreement, the Company will receive from the counterparty interest on the notional amount based on 1.5% plus one-month LIBOR and will pay to the counterparty a fixed rate of 3.744%. This swap effectively converted \$24,501,280 of variable-rate borrowings to fixed-rate borrowings beginning on January 2, 2009 and through July 1, 2013.

Companies are required to recognize all derivative instruments as either assets or liabilities at fair value on the balance sheet. The Company has designated this derivative instrument as a cash flow hedge. As such, changes in the fair value of the derivative instrument are recorded as a component of other comprehensive income (loss) (“OCI”) for the three months ended March 31, 2010 to the extent of effectiveness. The ineffective portion of the change in fair value of the derivative instrument is recognized in interest expense. For the three months ending March 31, 2010, the Company has determined this derivative instrument to be an effective hedge.

The Company does not use derivative instruments for trading or other speculative purposes and we did not have any other derivative instruments or hedging activities as of March 31, 2010.

6. **Fair Value of Financial Instruments** Certain of our assets and liabilities are disclosed at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various valuation methods including the market, income and cost approaches. The assumptions used in the application of these valuation methods are developed from the perspective of market participants, pricing the asset or liability. Inputs used in the valuation methods can be either readily observable, market corroborated, or generally unobservable inputs. Whenever possible the Company attempts to utilize valuation methods that maximize the uses of observable inputs and minimizes the use of unobservable inputs. Based on the operability of the inputs used in the valuation methods the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Assets and liabilities measured, reported and/or disclosed at fair value will be classified and disclosed in one of the following three categories:

Level 1 – Quoted market prices in active markets for identical assets or liabilities.

Level 2 – Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3 – Unobservable inputs that are not corroborated by market data.

The table below sets forth our fair value hierarchy for liabilities measured or disclosed at fair value as of March 31, 2010.

Agree Realty Corporation

| | Level 1 | Level 2 | Level 3 | |
|------------------------|---------|----------------|---------|------------|
| Liability: | | | | |
| Interest rate swap | \$ | —\$ 370,547 | \$ | — |
| Fixed rate mortgage | \$ | —\$ | —\$ | 47,910,700 |
| Variable rate mortgage | \$ | —\$ | —\$ | 21,492,645 |
| Variable rate debt | \$ | —\$ 29,797,000 | \$ | — |

The carrying amounts of the Company's short-term financial instruments, which consist of cash, cash equivalents, receivables, and accounts payable, approximate their fair values. The fair value of the interest rate swap was derived using estimates to settle the interest rate swap agreement, which is based on the net present value of expected future cash flows on each leg of the swap utilizing market-based inputs and discount rates reflecting the risks involved. The fair value of fixed and variable rate mortgages was derived using the present value of future mortgage payments based on estimated current market interest rates. The fair value of variable rate debt is estimated to be equal to the face value of the debt because the interest rates are floating and is considered to approximate fair value.

7. Total Comprehensive Income (Loss) The following is a reconciliation of net income to comprehensive income attributable to Agree Realty Corporation for the three months ended March 31, 2010 and 2009.

| | Three months ended | |
|---|--------------------|----------------|
| | March 31, 2010 | March 31, 2009 |
| Net income | \$ 9,968,480 | \$ 4,317,065 |
| Other comprehensive income (loss) | (370,547) | (279,970) |
| Total comprehensive income before non-controlling interest | 9,597,933 | 4,037,095 |
| Less: non-controlling interest | 402,392 | 306,419 |
| Total comprehensive income after non-controlling interest | 9,195,541 | 3,730,676 |
| Add: non-controlling interest of comprehensive loss | 11,023 | 19,878 |
| Comprehensive income attributable to Agree Realty Corporation | \$ 9,206,564 | \$ 3,750,554 |

8. Costs and Estimated Earnings on Uncompleted Contracts For contracts where the Company does not retain ownership of the real property, but the Company develops and receives fee income for managing the development project, the Company uses the percentage of completion accounting method. Under this approach, income is recognized based on the status of the uncompleted contracts and the current estimates of costs to complete. The percentage of completion is determined by the relationship of costs incurred to the total estimated costs of the contract. Provisions are made for estimated losses on uncompleted contracts in the period in which such losses are determined. Changes in job performance, job conditions, and estimated profitability including those arising from contract penalty provisions and final contract settlements, may result in revisions to costs and income. Such revisions are recognized in the period in which they are determined. Claims for additional compensation due the Company are recognized in contract revenues when realization is probable and the amount can be reliably

estimated.

Job-to-date amounts for open projects at March 31, 2010 is as follows:

| | |
|--|--------------|
| Cost incurred on uncompleted contracts | \$ 1,023,348 |
| Estimated earnings | 806,652 |
| Earned Revenue | 1,830,000 |
| Less billings to date | - |
| Total | \$ 1,830,000 |

Total unbilled revenues at March 31, 2010 are \$1,830,000 and are included in accounts receivable – tenants on the consolidated balance sheet.

9. Notes Payable
- Agree Limited Partnership (the “Operating Partnership”) has in place a \$55 million Credit Facility with Bank of America, as the agent, which is guaranteed by the Company. The Credit Facility was extended in January 2009 and now matures in November 2011. Advances under the Credit Facility bear interest within a range of one-month to 12-month LIBOR plus 100 basis points to 150 basis points or the lender’s prime rate, at the Company’s option, based on certain factors such as the ratio of our indebtedness to the capital value of the Company’s properties properties. The Credit Facility generally is used to fund property acquisitions and development activities. As of March 31, 2010, \$28,500,000 was outstanding under the Credit Facility bearing a weighted average interest rate of 1.23%.

The Company also has in place a \$5 million Line of Credit that was extended in October 2009 and now matures in November 2011. The Line of Credit bears interest at the lender’s prime rate less 75 basis points or 150 basis points in excess of the one-month to 12-month LIBOR rate, at the Company’s option. The purpose of the Line of Credit is generally to provide working capital and fund land options and start-up costs associated with new projects. As of March 31, 2010, \$1,297,500 was outstanding under the Line of Credit bearing a weighted average interest rate of 2.50%.

10. Discontinued Operations
- In March 2010, the Company completed the sale of a single tenant property for approximately \$9.8 million. The property was leased to Borders Group, Inc. and was located in Santa Barbara, California. The results of operations for this property are presented as discontinued operations in the Company’s Consolidated Statements of Income. The revenues for the property were \$179,293 and \$180,016 for the three months ended March 31, 2010 and 2009, respectively. The expenses for the property were \$-0- and \$723 for the three months ended March 31, 2010 and 2009, respectively.
11. Restricted Cash
- Pursuant to an agreement with an unrelated third party, cash held in escrow is for the acquisition of real estate.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

We have included herein certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements represent our expectations, plans and beliefs concerning future events and may be identified by terminology such as "anticipate," "estimate," "should," "expect," "believe," "intend" and similar expressions. Although the forward-looking statements made in this report are based on good faith beliefs and our reasonable judgment reflecting current information, certain factors could cause actual results to differ materially from such forward-looking statements, including but not limited to: the ongoing U.S. recession, the existing global credit and financial crisis and other changes in general economic, financial and real estate market conditions; risks that our acquisition and development projects will fail to perform as expected; financing risks, such as the inability to obtain debt or equity financing on favorable terms or at all; the level and volatility of interest rates; loss or bankruptcy of one or more of our major retail tenants; a failure of our properties to generate additional income to offset increases in operating expenses; and other factors discussed in Part II, Item 1A. "Risk Factors" and elsewhere in this report and our other reports furnished or filed with the Securities and Exchange Commission, ("SEC") including our annual report on Form 10-K for the fiscal year ended December 31, 2009. Given these uncertainties, you should not place undue reliance on our forward-looking statements. Except as required by law, we assume no obligation to update these forward-looking statements, even if new information becomes available in the future.

Overview

Agree Realty Corporation is a fully-integrated, self-administered and self-managed real estate investment trust ("REIT") focused primarily on the ownership, development, acquisition and management of retail properties net leased to national tenants. In this report, the terms "Company," "we," "our" and "us" and similar terms refer to Agree Realty Corporation and its subsidiaries as the context may require. We were formed in December 1993 to continue and expand the business founded in 1971 by our current Chief Executive Officer and Chairman, Richard Agree. We specialize in developing retail properties for national tenants who have executed long-term net leases prior to the commencement of construction. As of March 31, 2010, approximately 89% of our annualized base rent was derived from national tenants and approximately 69% of our annualized base rent was derived from our top three tenants: Walgreen Co. ("Walgreens") – 31%; Borders Group, Inc. – 27% and Kmart Corporation – 11%. All of our freestanding property tenants and the majority of our community shopping center tenants have triple-net leases, which require the tenant to be responsible for property operating expenses, including property taxes, insurance and maintenance. We believe this strategy provides a generally consistent source of income and cash for distributions.

As of March 31, 2010, our portfolio consisted of 72 properties, located in 15 states containing an aggregate of approximately 3.5 million square feet of gross leasable area ("GLA"). As of March 31, 2010, our portfolio included 60 freestanding net leased properties and 12 community shopping centers that were 98.1% leased in aggregate with a weighted average lease term of approximately 10.25 years remaining. During the period from January 1, 2010 to December 31, 2011 we have 30 leases that are scheduled to expire assuming that none of the tenants exercise renewal options or terminate their leases prior to the contractual expiration date. These leases represent 245,019 square feet of GLA and \$1,835,431 of annualized base rent.

We expect to continue to grow our asset base primarily through the development of retail properties that are pre-leased on a long-term basis to national tenants. We focus on development because we believe, based on the historical returns

we have been able to achieve, it generally provides us a higher return on investment than the acquisition of similarly located properties and does not entail the risks associated with speculative development. Since our initial public offering in 1994, we have developed 59 of our 72 properties, including 47 of our 60 freestanding properties and all 12 of our community shopping centers. As of March 31, 2010, the properties that we developed accounted for 84.0% of our annualized base rent. We expect to continue to expand our existing tenant relationships and diversify our tenant base to include other quality national tenants.

On March 31, 2010, we completed the sale of our Borders Superstore located in Santa Barbara, California. The property was sold to an unrelated party for \$9.8 million. We expect to utilize the proceeds from this transaction to acquire retail properties leased to credit worthy tenants.

Our assets are held by, and all operations are conducted through, Agree Limited Partnership (the "Operating Partnership"), of which we are the sole general partner and held a 95.96% and 95.93% interest as of March 31, 2010 and December 31, 2009, respectively. We are operating so as to qualify as a REIT for federal income tax purposes.

The following should be read in conjunction with the Consolidated Financial Statements of Agree Realty Corporation, including the respective notes thereto, which are included in this Form 10-Q.

Critical Accounting Policies

Critical accounting policies are those that are both significant to the overall presentation of our financial condition and results of operations and require management to make difficult, complex or subjective judgments. For example, significant estimates and assumptions have been made with respect to revenue recognition, capitalization of costs related to real estate investments, potential impairment of real estate investments, operating cost reimbursements, and taxable income.

Minimum rental income attributable to leases is recorded when due from tenants. Certain leases provide for additional percentage rents based on tenants' sales volumes. These percentage rents are recognized when determinable by us. In addition, leases for certain tenants contain rent escalations and/or free rent during the first several months of the lease term; however, such amounts are not material.

Real estate assets are stated at cost less accumulated depreciation. All costs related to planning, development and construction of buildings prior to the date they become operational, including interest and real estate taxes during the construction period, are capitalized for financial reporting purposes and recorded as property under development until construction has been completed. The viability of all projects under construction or development is regularly evaluated under applicable accounting requirements, including requirements relating to abandonment of assets or changes in use. To the extent a project, or individual components of the project, are no longer considered to have value, the related capitalized costs are charged against operations. Subsequent to the completion of construction, expenditures for property maintenance are charged to operations as incurred, while significant renovations are capitalized. Depreciation of the buildings is recorded in accordance with the straight-line method using an estimated useful life of 40 years.

We evaluate real estate for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through estimated undiscounted future cash flows from the use of these assets. When any such impairment exists, the related assets will be written down to fair value and such excess carrying value is charged to income. The expected cash flows of a project are dependent on estimates and other factors subject to change, including (1) changes in the national, regional, and/or local economic climates, (2) competition from other shopping centers, stores, clubs, mailings, and the internet, (3) increases in operating costs, (4) bankruptcy and/or other changes in the condition of third parties, including tenants, (5) expected holding period, and (6) availability of credit. These factors could cause our expected future cash flows from a project to change, and, as a result, an impairment could be considered to have occurred.

Substantially all of our leases contain provisions requiring tenants to pay as additional rent a proportionate share of operating expenses ("operating cost reimbursements") including real estate taxes, repairs and maintenance and

insurance. The related revenue from tenant billings is recognized in the same period the expense is recorded.

We have elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the "Code"), commencing with our taxable year ended December 31, 1994. As a result, we are not subject to federal income taxes to the extent that we distribute annually at least 90% of our REIT taxable income to our stockholders and satisfy certain other requirements defined in the Code.

We have established taxable REIT subsidiaries (“TRS”) pursuant to the provisions of the REIT Modernization Act. Our TRS entities are able to engage in activities resulting in income that previously would have been disqualified from being eligible REIT income under the federal income tax regulations. As a result, certain of our activities which occur within our TRS entities are subject to federal and state income taxes. As of March 31, 2010 and December 31, 2009, we had accrued a deferred income tax amount of \$705,000.

Comparison of Three Months Ended March 31, 2010 to Three Months Ended March 31, 2009

Minimum rental income increased \$106,000, or 1%, to \$8,437,000 in 2010, compared to \$8,331,000 in 2009. The increase was the result of the development of a Walgreens drug store in Brighton, Michigan in February 2009, the development of a Walgreens drug store in Port St John, Florida in June 2009, the development of a Walgreens drug store in Lowell, Michigan in September 2009 and the development of a Chase bank land lease in Southfield, Michigan in October 2009. Our revenue increase from these developments amounted to \$254,000. In addition, rental income decreased (\$148,000) as a result of the closing of a Circuit City store in Boynton Beach, Florida and other rent adjustments.

Percentage rents decreased from \$7,000 in 2009 to \$-0- in 2010.

Operating cost reimbursements decreased \$49,000, or 7%, to \$670,000 in 2010, compared to \$719,000 in 2009. Operating cost reimbursements decreased due to the net decrease in real estate taxes and property operating expenses explained below.

We earned development fee income of \$397,000 in 2010 related to a project we have commenced in Oakland, California. There was no development fee income in 2009.

Other income increased to \$18,000 in 2010, compared to \$4,000 in 2009.

Real estate taxes increased \$10,000, or 2%, to \$489,000 in 2010, compared to \$479,000 in 2009. The change was the result of general assessment adjustments.

Property operating expenses (shopping center maintenance, snow removal, insurance and utilities) decreased \$63,000, or 14%, to \$396,000 in 2010 compared to \$459,000 in 2009. The decrease was the result of: a decrease in snow removal costs of (\$58,000) a decrease in shopping center maintenance costs of (\$8,000); an increase in utility costs of \$7,000 and a decrease in insurance costs of (\$4,000) in 2010 versus 2009.

Land lease payments increased \$12,000, or 5%, to \$227,000 in 2010, compared to \$215,000 for 2009. The increase was the result of a contractual increase in our rent payment at our Aventura, Florida property.

General and administrative expenses increased by \$1,000, to \$1,252,000 in 2010, compared to \$1,251,000 in 2009. General and administrative expenses as a percentage of total rental income (minimum and percentage rents) decreased from 14.69% for 2009 to 14.53% for 2010.

Depreciation and amortization increased \$38,000, or 3%, to \$1,432,000 in 2010, compared to \$1,394,000 in 2009. The increase was the result of the development of five properties in 2009.

Interest expense increased \$144,000, or 13%, to \$1,270,000 in 2010, compared to \$1,126,000 in 2009. The increase in interest expense is a result of our funding the development of five properties in 2009.

We recognized a gain \$5,332,000 on the sale of our Borders Books store located in Santa Barbara, California in 2010. We had no property sales in 2009.

Our net income increased \$5,555,000, or 8%, to \$9,566,000 in 2010 from \$4,011,000 in 2009 as a result of the foregoing factors.

Liquidity and Capital Resources

Our principal demands for liquidity are operations, distributions to our stockholders, debt repayment, development of new properties, redevelopment of existing properties and future property acquisitions. We intend to meet our short-term liquidity requirements, including capital expenditures related to the leasing and improvement of the properties, through cash flow provided by operations and our \$55 million credit facility (the "Credit Facility") and our \$5 million line of credit (the "Line of Credit"). We believe that adequate cash flow will be available to fund our operations and pay dividends in accordance with REIT requirements for at least the next 12 months. We may obtain additional funds for future development or acquisitions through other borrowings or the issuance of additional shares of common stock. We believe that these financing sources will enable us to generate funds sufficient to meet both our short-term and long-term capital needs.

We intend to maintain a ratio of total indebtedness (including construction or acquisition financing) to market capitalization of 65% or less. Nevertheless, we may operate with debt levels which are in excess of 65% of market capitalization for extended periods of time. At March 31, 2010, our ratio of indebtedness to market capitalization was approximately 53%.

During the quarter ended March 31, 2010, we declared a quarterly dividend of \$0.51 per share. We paid the dividend on April 13, 2010 to holders of record on March 31, 2010.

Our cash flows from operations decreased \$384,000 to \$5,072,000 for the three months ended March 31, 2010, compared to \$5,456,000 for the three months ended March 31, 2009. Cash used in investing activities decreased \$999,000 to \$243,000 in 2010, compared to \$1,242,000 in 2009. Cash used in financing activities increased \$332,000 to \$4,953,000 in 2010, compared to \$4,621,000 in 2009.

As of March 31, 2010, we had total mortgage indebtedness of \$74,570,951. Of this total mortgage indebtedness, \$50,535,759 is fixed rate, self-amortizing debt with a weighted average interest rate of 6.56%. The remaining mortgage debt of \$24,035,192 bears interest at 150 basis points over LIBOR or 1.75% as of March 31, 2010 and has a maturity date of July 14, 2013, which can be extended at our option for two additional years. In January 2009, we entered into an interest rate swap agreement that fixes the interest rate during the initial term of the variable-interest mortgage at 3.744%.

In addition, the Operating Partnership has in place the \$55 million Credit Facility with Bank of America, as the agent, which is guaranteed by us. The Credit Facility was extended in January 2009 and now matures in November 2011. Advances under the Credit Facility bear interest within a range of one-month to 12-month LIBOR plus 100 basis points to 150 basis points or the lender's prime rate, at our option, based on certain factors such as the ratio of our indebtedness to the capital value of our properties. The Credit Facility generally is used to fund property acquisitions and development activities. As of March 31, 2010, \$28,500,000 was outstanding under the Credit Facility bearing a weighted average interest rate of 1.23%.

We also have in place the \$5 million Line of Credit that was extended in October 2009 and now matures in November 2011. The Line of Credit bears interest at the lender's prime rate less 75 basis points or 150 basis points in excess of the one-month to 12-month LIBOR rate, at our option. The purpose of the Line of Credit is generally to provide

working capital and fund land options and start-up costs associated with new projects. As of March 31, 2010, \$1,297,500 was outstanding under the Line of Credit bearing a weighted average interest rate of 2.50%.

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On April 16, 2010 we completed a secondary offering of 1,495,000 shares of common stock. The offering, which included the exercise of the over-allotment option by the underwriter, raised approximately \$31.1 million. The proceeds from the offering were used to pay down amounts outstanding under our credit facilities.

The following table outlines our contractual obligations as of March 31, 2010 for the periods presented below (in thousands).

| | Total | Apr 1, 2010 – Ma 31, 2011 | Apr 1, 2011 – Mar 31, 2013 | Apr 1, 2013 – Mar 31, 2015 | Thereafter |
|---|-------------------|------------------------------|-------------------------------|-------------------------------|------------------|
| Mortgages Payable | \$ 74,571 | \$ 4,091 | \$ 9,023 | \$ 31,518 | \$ 29,939 |
| Notes Payable | 29,797 | — | 29,797 | — | — |
| Land Lease Obligation | 12,858 | 906 | 1,813 | 1,726 | 8,413 |
| Estimated Interest Payments on Mortgages and Notes Payable | 19,060 | 3,791 | 6,441 | 4,987 | 3,841 |
| Other Long-Term Liabilities | — | — | — | — | — |
| Total | \$ 136,286 | \$ 8,788 | \$ 47,074 | \$ 38,231 | \$ 42,193 |

We plan to begin construction of additional pre-leased developments and may acquire additional properties, which will initially be financed by the Credit Facility and Line of Credit. We will periodically refinance short-term construction and acquisition financing with long-term debt and/or equity to the extent available.

Off-Balance Sheet Arrangements

We do not engage in any off-balance sheet arrangements with unconsolidated entities or financial partnerships, such as structured finance or special purpose entities.

Inflation

Our leases generally contain provisions designed to mitigate the adverse impact of inflation on net income. These provisions include clauses enabling us to pass through to tenants certain operating costs, including real estate taxes, common area maintenance, utilities and insurance, thereby reducing our exposure to increases in costs and operating expenses resulting from inflation. Certain of our leases contain clauses enabling us to receive percentage rents based on tenants' gross sales, which generally increase as prices rise, and, in certain cases, escalation clauses, which generally increase rental rates during the terms of the leases. In addition, expiring tenant leases permit us to seek increased rents upon re-lease at market rates if rents are below the then existing market rates.

Funds from Operations

Funds from Operations (“FFO”) is defined by the National Association of Real Estate Investment Trusts, Inc. (“NAREIT”) to mean net income computed in accordance with generally accepted accounting principles (“GAAP”), excluding gains (or losses) from sales of property, plus real estate related depreciation and amortization and after adjustments for unconsolidated partnerships and joint ventures. Management uses FFO as a supplemental measure to conduct and evaluate our business because there are certain limitations associated with using GAAP net income by itself as the primary measure of our operating performance. Historical cost accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values instead have historically risen or fallen with market conditions, management believes that the presentation of

operating results for real estate companies that use historical cost accounting is insufficient by itself.

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FFO should not be considered as an alternative to net income as the primary indicator of our operating performance or as an alternative to cash flow as a measure of liquidity. Further, while we adhere to the NAREIT definition of FFO, our presentation of FFO is not necessarily comparable to similarly titled measures of other REITs due to the fact that not all REITs use the same definition.

The following table provides a reconciliation of FFO and net income for the three months ended March 31, 2010 and 2009:

| | Three Months Ended March 31, | |
|--|---------------------------------|--------------|
| | 2010 | 2009 |
| Net income | \$ 9,968,480 | \$ 4,317,065 |
| Depreciation of real estate assets | 1,400,791 | 1,361,318 |
| Amortization of leasing costs | 19,027 | 16,024 |
| Gain on sale of fixed asset | (5,331,685) | - |
| Funds from Operations | \$ 6,056,613 | \$ 5,694,407 |
| Weighted Average Shares and Operating Partnership Units Outstanding – Dilutive | 8,477,909 | 8,387,153 |

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to interest rate risk primarily through borrowing activities. There is inherent roll-over risk for borrowings as they mature and are renewed at current market rates. The extent of this risk is not quantifiable or predictable because of the variability of future interest rates and our future financing requirements. Our interest rate risk is monitored using a variety of techniques. The table below presents the principal payments (in thousands) and the weighted average interest rates on outstanding debt, by year of expected maturity, to evaluate the expected cash flows and sensitivity to interest rate changes.

| | Year ended March 31, | | | | | | |
|--|----------------------|------|------|------|------|------------|-------|
| | 2011 | 2012 | 2013 | 2014 | 2015 | Thereafter | Total |