

AGREE REALTY CORP  
Form 10-Q  
November 07, 2006

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**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 September 30, 2006**

**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  
of incorporation or organization)

(I.R.S. Employer  
Identification No.)

**31850 Northwestern Highway, Farmington Hills, Michigan**

**48334**

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, included 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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

As of November 7, 2006 the Registrant had 7,716,646 shares of common stock, \$.0001 par value outstanding.

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Section 906 Certification of Cheif Executive Officer

Section 906 Certification of Cheif Financial Officer

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**Agree Realty Corporation**  
**Consolidated Balance Sheets (Unaudited)**

	<i>September 30, 2006</i>	<i>December 31, 2005</i>
<b>Assets</b>		
<b>Real Estate Investments</b>		
Land	\$ 74,033,627	\$ 73,035,167
Buildings	186,408,296	185,032,185
Property under development	2,767,460	264,913
	<b>263,209,383</b>	258,332,265
Less accumulated depreciation	<b>(47,149,548)</b>	(43,771,581)
<b>Net Real Estate Investments</b>	<b>216,059,835</b>	214,560,684
<b>Cash and Cash Equivalents</b>	<b>164,292</b>	5,714,540
<b>Accounts Receivable – Tenants</b> , net of allowance of \$20,000 for possible losses for 2006 and 2005	<b>405,447</b>	730,606
<b>Unamortized Deferred Expenses</b>		
Financing costs, net of accumulated amortization of \$4,437,244 and \$4,344,244	<b>759,036</b>	852,036
Leasing costs, net of accumulated amortization of \$653,629 and \$621,388	<b>420,820</b>	389,354
<b>Other Assets</b>	<b>802,745</b>	1,212,387
	<b>\$ 218,612,175</b>	\$ 223,459,607

*See accompanying notes to consolidated financial statements.*

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**Agree Realty Corporation**  
**Consolidated Balance Sheets (Unaudited)**

	<i>September 30, 2006</i>	<i>December 31, 2005</i>
<b>Liabilities and Stockholders' Equity</b>		
<b>Mortgage Payable</b>	<b>\$ 48,914,021</b>	<b>\$ 50,721,920</b>
<b>Notes Payable</b>	<b>15,650,000</b>	<b>17,500,000</b>
<b>Dividends and Distributions Payable</b>	<b>4,110,764</b>	<b>4,089,243</b>
<b>Deferred Revenue</b>	<b>12,276,342</b>	<b>12,793,504</b>
<b>Accrued Interest Payable</b>	<b>302,184</b>	<b>282,080</b>
<b>Accounts Payable</b>		
Capital expenditures	<b>864,778</b>	<b>112,687</b>
Operating	<b>278,137</b>	<b>1,300,416</b>
<b>Tenant Deposits</b>	<b>60,140</b>	<b>54,062</b>
<b>Total Liabilities</b>	<b>82,456,366</b>	<b>86,853,912</b>
<b>Minority Interest</b>	<b>5,885,109</b>	<b>5,978,635</b>
<b>Stockholders' Equity</b>		
Common stock, \$.0001 par value; 20,000,000 shares authorized, 7,716,646 and 7,706,846 shares issued and outstanding	<b>772</b>	<b>772</b>
Additional paid-in capital	<b>141,066,309</b>	<b>140,343,759</b>
Deficit	<b>(10,796,381)</b>	<b>(9,717,471)</b>
<b>Total Stockholders' Equity</b>	<b>130,270,700</b>	<b>130,627,060</b>
	<b>\$ 218,612,175</b>	<b>\$ 223,459,607</b>

*See accompanying notes to consolidated financial statements.*

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**Agree Realty Corporation**  
**Consolidated Statements of Income (Unaudited)**

	<i>Nine Months Ended September 30, 2006</i>	<i>Nine Months Ended September 30, 2005</i>
<b>Revenues</b>		
Minimum rents	\$ 22,415,582	\$ 21,096,534
Percentage rents	40,891	39,299
Operating cost reimbursements	2,060,329	2,097,318
Other income	37,026	24,033
<b>Total Revenues</b>	<b>24,553,828</b>	<b>23,257,184</b>
<b>Operating Expenses</b>		
Real estate taxes	1,351,988	1,315,800
Property operating expenses	1,317,509	1,434,459
Land lease payments	586,395	586,395
General and administrative	3,078,733	2,665,207
Depreciation and amortization	3,618,495	3,461,429
<b>Total Operating Expenses</b>	<b>9,953,120</b>	<b>9,463,290</b>
<b>Income From Continuing Operations</b>	<b>14,600,708</b>	<b>13,793,894</b>
<b>Other (Expense)</b>		
Interest expense, net	(3,449,164)	(3,056,760)
<b>Income Before Minority Interest and Discontinued Operations</b>	<b>11,151,544</b>	<b>10,737,134</b>
<b>Minority Interest</b>	<b>(896,588)</b>	<b>(878,644)</b>
<b>Income Before Discontinued Operations</b>	<b>10,254,956</b>	<b>9,858,490</b>
<b>Income From Discontinued Operations, net of minority interest of \$37,060</b>		415,997
<b>Net Income</b>	<b>\$ 10,254,956</b>	<b>\$ 10,274,487</b>

**Basic Earnings Per Share**

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Income before discontinued operations	\$	1.35	\$	1.30
Discontinued operations				.06
<b>Earnings Per Share Basic</b>	<b>\$</b>	<b>1.35</b>	<b>\$</b>	<b>1.36</b>
<b>Earnings Per Share Dilutive</b>	<b>\$</b>	<b>1.34</b>	<b>\$</b>	<b>1.36</b>
<b>Cash Dividends Declared Per Common Share</b>	<b>\$</b>	<b>1.47</b>	<b>\$</b>	<b>1.47</b>
<b>Weighted Average Number of Common Shares Outstanding Basic</b>		<b>7,603,837</b>		<b>7,559,973</b>
<b>Weighted Average Number of Common Shares Outstanding Dilutive</b>		<b>7,666,366</b>		<b>7,560,318</b>

*See accompanying notes to consolidated financial statements.*



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**Agree Realty Corporation**  
**Consolidated Statements of Income (Unaudited)**

	<i>Three Months Ended September 30, 2006</i>	<i>Three Months Ended September 30, 2005</i>
<b>Revenues</b>		
Minimum rents	\$ 7,452,909	\$ 7,061,614
Percentage rents	13,606	14,227
Operating cost reimbursements	638,900	613,083
Other income	8,545	7,398
<b>Total Revenues</b>	<b>8,113,960</b>	<b>7,696,322</b>
<b>Operating Expenses</b>		
Real estate taxes	449,823	444,107
Property operating expenses	389,237	341,983
Land lease payments	195,465	195,465
General and administrative	1,005,902	911,515
Depreciation and amortization	1,212,660	1,167,652
<b>Total Operating Expenses</b>	<b>3,253,087</b>	<b>3,060,722</b>
<b>Income From Continuing Operations</b>	<b>4,860,873</b>	<b>4,635,600</b>
<b>Other (Expense)</b>		
Interest expense, net	(1,156,949)	(1,028,876)
<b>Income Before Minority Interest and Discontinued Operations</b>	<b>3,703,924</b>	<b>3,606,724</b>
<b>Minority Interest</b>	<b>(297,797)</b>	<b>(291,063)</b>
<b>Income Before Discontinued Operations</b>	<b>3,406,127</b>	<b>3,315,661</b>
<b>Income From Discontinued Operations, net of minority interest of \$12,146</b>		<b>138,365</b>
<b>Net Income</b>	<b>\$ 3,406,127</b>	<b>\$ 3,454,026</b>
<b>Basic Earnings Per Share</b>		

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Income before discontinued operations	\$	<b>.45</b>	\$	.43
Discontinued operations				.02
<b>Earnings Per Share    Basic</b>	\$	<b>.45</b>	\$	.45
<b>Earnings Per Share    Dilutive</b>	\$	<b>.44</b>	\$	.45
<b>Cash Dividend Declared Per Common Share</b>	\$	<b>.49</b>	\$	.49
<b>Weighted Average Number of Common Shares Outstanding Basic</b>		<b>7,607,808</b>		7,670,598
<b>Weighted Average Number of Common Shares Outstanding Dilutive</b>		<b>7,672,549</b>		7,672,290

*See accompanying notes to consolidated financial statements.*

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**Agree Realty Corporation**  
**Consolidated Statement of Stockholders' Equity (Unaudited)**

	<i>Common Stock</i>		<i>Additional</i>	
	<i>Shares</i>	<i>Amount</i>	<i>Paid-In</i>	<i>Deficit</i>
			<i>Capital</i>	
<b>Balance, January 1, 2006</b>	7,706,846	\$ 772	\$ 140,343,759	\$ (9,717,471)
Issuance of shares under the Equity Incentive Plan	9,800		95,550	
Vesting of restricted stock			627,000	
Dividends declared for the period January 1, 2006 to September 30, 2006				(11,333,866)
Net income for the period January 1, 2006 to September 30, 2006				10,254,956
<b>Balance, September 30, 2006</b>	7,716,646	\$ 772	\$ 141,066,309	\$ (10,796,381)

*See accompanying notes to consolidated financial statements.*

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**Agree Realty Corporation**  
**Consolidated Statement of Cash Flows (Unaudited)**

	<i>Nine Months Ended September 30, 2006</i>	<i>Nine Months Ended September 30, 2005</i>
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 10,254,956	\$ 10,274,487
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	3,580,590	3,560,786
Amortization	130,905	155,931
Stock-based compensation	627,000	490,760
Minority interests	896,588	915,704
Gain on sale of assets		(6,397)
Decrease in accounts receivable	325,159	474,406
Decrease in other assets	357,952	208,995
Decrease in accounts payable	(1,022,279)	(1,081,225)
Decrease in deferred revenue	(517,162)	(517,162)
Increase (decrease) in accrued interest	20,104	(57,146)
Increase (decrease) in tenant deposits	6,078	(4,399)
<b>Net Cash Provided By Operating Activities</b>	<b>14,659,891</b>	<b>14,414,740</b>
<b>Cash Flows From Investing Activities</b>		
Acquisition of real estate investments (including capitalized interest of \$111,000 in 2006 and \$390,000 in 2005)	(4,168,937)	(5,397,651)
Net proceeds from the sale of assets		1,176,263
<b>Net Cash Used In Investing Activities</b>	<b>(4,168,937)</b>	<b>(4,221,388)</b>
<b>Cash Flows From Financing Activities</b>		
Net proceeds from the issuance of common stock	95,550	31,456,414
Payments of mortgages payable	(1,807,899)	(1,657,528)
Dividends and limited partners distributions paid	(12,302,459)	(11,690,002)
Line-of-credit net borrowings (payments)	(1,850,000)	(28,000,000)
Repayments of capital expenditure payables	(112,687)	(393,711)
Redemption of restricted stock		(126,760)
Payment of leasing costs	(63,707)	(179,395)
<b>Net Cash Provided By (Used In) Financing Activities</b>	<b>(16,041,202)</b>	<b>(10,590,982)</b>

<b>Net Decrease In Cash and Cash Equivalents</b>	<b>(5,550,248)</b>		<b>(397,630)</b>
<b>Cash and Cash Equivalents, beginning of period</b>	<b>5,714,540</b>		<b>587,524</b>
<b>Cash and Cash Equivalents, end of period</b>	<b>\$ 164,292</b>	<b>\$</b>	<b>189,894</b>

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**Agree Realty Corporation**  
**Consolidated Statement of Cash Flows (Unaudited)**

	<i>Nine Months Ended September 30, 2006</i>	<i>Six Months Ended September 30, 2005</i>
<b>Supplemental Disclosure of Cash flow Information</b>		
Cash paid for interest (net of amounts capitalized)	\$ 3,337,297	\$ 2,999,907
<b>Supplemental Disclosure of Non-Cash Transactions</b>		
Dividends and limited partners distributions declared and unpaid	\$ 4,110,764	\$ 4,088,262
Shares issued under Stock Incentive Plan	\$ 149,989	\$ 1,162,070
Real estate investments financed with accounts payable	\$ 864,778	\$ 418,057

*See accompanying notes to consolidated financial statements.*

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**Agree Realty Corporation**  
**Notes to Consolidated Financial Statements**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements for the three months and nine months ended September 30, 2006 and 2005 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 complete 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, 2005 has been derived from the audited consolidated financial statements at that date. Operating results for the nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006, or for any other interim period. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005.

**2. Discontinued Operations**

During November 2005, we completed the sale of a shopping center for approximately \$8.8 million. The shopping center was anchored by Kmart Corporation and Roundy's Foods and was located in Iron Mountain, Michigan. The results of operations for this property is presented as discontinued operations in our Consolidated Statements of Income.

The aggregate revenues from this property were \$785,308 for the nine months ended September 30, 2005. The expenses for this property were \$369,311, including minority interest charges of \$37,060, for the nine months ended September 30, 2005.

The aggregate revenues from this property were \$256,835 for the three months ended September 30, 2005. The expenses for this property were \$118,470, including minority interest charges of \$12,146 for the three months ended September 30, 2005.

**3. Equity Transactions**

On January 25, 2005, we completed an offering of 1,000,000 shares of common stock at \$28.28 per share; on February 7, 2005 the underwriter exercised its over allotment option for an additional 150,000 shares at the same per share price (collectively, the 2005 Offering). The net proceeds from the 2005 Offering of approximately \$31.5 million were used to repay amounts outstanding under our credit facility.

**4. Stock Based Compensation**

On January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (R), Share-Based Payments (SFAS 123R), under the modified prospective method. Under the modified prospective method, compensation cost is recognized for all awards granted after the adoption of this standard and for the unvested portion of previously granted awards that are outstanding as of that date. In accordance with SFAS 123R, we will estimate fair value of restricted stock and stock option grants at the date of grant and amortize

those amounts into expense on a straight line basis or amount vested, if greater,  
over the appropriate vesting period.

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**Agree Realty Corporation**  
**Notes to Consolidated Financial Statements**

**4. Stock Based Compensation (continued)**

Adoption of SFAS 123R did not have an impact on our earnings from continuing operations, net earnings, cash flow from operations, cash flow from financing activities and basic and diluted earnings per share for the quarter ended September 30, 2006.

As of September 30, 2006, there was \$2,317,724 of total unrecognized compensation costs related to the outstanding restricted shares, which is expected to be recognized over a weighted average period of 3.55 years. We 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 and we do not consider discount rates to be material.

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 shareholder of the Company, including the right to vote the shares and the right to receive dividends on the shares. On July 21, 2006 the Company granted restricted shares to under the 2005 Equity Incentive Plan. The restricted shares vest over a three-year period based on continued service to the Company. Restricted share activity is summarized as follows:

	Shares Outstanding	Weighted Average Grant Date Fair Value
Non-vested restricted shares at December 31, 2005	129,440	\$26.61
Restricted shares granted	4,900	\$30.61
Restricted shares vested	(29,320)	\$23.13
Restricted shares forfeited		
Non-vested restricted shares, at September 30, 2006	105,020	\$27.76

**5. Earnings Per Share**

Earnings per share has been computed by dividing the net income by the weighted average number of common shares outstanding. The per share amounts reflected in the consolidated statements of income are presented in accordance with Statement of Financial Accounting Standards (SFAS) No. 128 Earnings per Share.

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:

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<b>Agree Realty Corporation</b>		
<b>Part I</b>		
	<b>Nine Months Ended Sep 30,</b>	
	<b>2006</b>	<b>2005</b>
Weighted average number of common shares outstanding	7,708,857	7,559,973
Unvested restricted stock	(105,020)	
Weighted average number of common shares outstanding used in basic earnings per share	7,603,837	7,559,973
Weighted average number of common shares outstanding used in basic earnings per share	7,603,837	7,559,973
Effect of dilutive securities:		
Restricted stock	61,244	
Common stock options	1,285	345
Weighted average number of common shares outstanding used in diluted earnings per share	7,666,366	7,560,318
	<b>Three Months Ended Sep 30,</b>	
	<b>2006</b>	<b>2005</b>
Weighted average number of common shares outstanding	7,712,828	7,670,598
Unvested restricted stock	(105,020)	
Weighted average number of common shares outstanding used in basic earnings per share	7,607,808	7,670,598
Weighted average number of common shares outstanding used in basic earnings per share	7,607,808	7,670,598
Effect of dilutive securities:		
Restricted stock	63,394	
Common stock options	1,347	1,692
Weighted average number of common shares outstanding used in diluted earnings per share	7,672,549	7,672,290

*See accompanying accountants' review report.*

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**Agree Realty Corporation  
Part I**

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

***Forward-Looking Statements***

Management has 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 and Exchange Act of 1934, as amended. When used, statements which are not historical in nature, including the words anticipate, estimate, should, expect, intend and similar expressions, are intended to identify forward-looking statements. Such statements are, by their nature, subject to certain risks and uncertainties. Risks and other factors that might cause future results to differ from the statements include, but are not limited to, the effect of economic and 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; the level and volatility of interest rates; loss or bankruptcy of one or more of our major retail tenants; and failure of our properties to generate additional income to offset increases in operating expenses. For a description of the specific risks associated with the operation of our business, please see our Form 10-K for the fiscal year ended December 31, 2005.

***Overview***

We were established to continue to operate and expand the retail property business of our predecessor. We commenced operations in April 1994. Our assets are held by, and all operations are conducted through, Agree Limited Partnership (the Operating Partnership), of which Agree Realty Corporation is the sole general partner and held a 91.97% interest as of September 30, 2006. We are operating so as to qualify as a real estate investment trust (REIT) for federal income tax purposes.

On January 25, 2005, we completed an offering of 1,000,000 shares of common stock at \$28.28 per share. On February 7, 2005, the underwriter exercised its over allotment option for an additional 150,000 shares at the same per share price (collectively, the 2005 Offering). The net proceeds from the 2005 Offering of approximately \$31.5 million were used to repay amounts outstanding our credit facility.

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.

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Part I*****Recent Accounting Pronouncements***

In December 2004, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 123 (R), to expand and clarify SFAS No. 123 in several areas. The Statement requires companies to measure the cost of employee services received in exchange for an award of an equity instrument based on the grant-date fair value of the award. The cost is recognized over the requisite service period (usually the vesting period) for the estimated number of instruments where service is expected to be rendered. This statement is effective for the interim reporting periods beginning after December 15, 2005. The Company adopted this statement in the first quarter of 2006. The impact of adopting SFAS No. 123 (R) did not have a material impact on the Company's financial position or results of operations.

In June 2006, the FASB issued an Emerging Issues Task Force (EITF) Consensus in Issue 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation). The consensus includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise taxes. The consensus states that the presentation of taxes within the scope on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed pursuant to Accounting Principles Board (APB) Opinion No. 22 Disclosure of Accounting Policies. In addition, for any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. The disclosure of those taxes can be done on an aggregate basis. The consensus should be applied to financial reports for interim and annual reporting periods beginning after December 15, 2006. The adoption of this consensus is not expected to have a significant impact on our financial position or results of operations.

***Critical Accounting Policies***

In the course of developing and evaluating accounting policies and procedures, we use estimates, assumptions and judgments to determine the most appropriate methods to be applied. Such processes are used in determining 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. Subsequent to completion of construction, expenditures for property maintenance

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**Agree Realty Corporation**  
**Part I**

are charged to operations as incurred, while significant renovations are capitalized. Depreciation of the buildings is recorded on the straight-line method using an estimated useful life of forty years.

In determining the fair value of real estate investments, we consider future cash flow projections on a property by property basis, current interest rates and current market conditions of the geographical location of each property. Substantially all of our leases contain provisions requiring tenants to pay as additional rent a proportionate share of operating expenses (Operating Cost Reimbursements) such as real estate taxes, repairs and maintenance, insurance, etc. The related revenue from tenant billings is recognized in the same period the expense is recorded.

We account for stock-based compensation in accordance with SFAS No. 123(R), Share-Based Payment. Under the fair value recognition provisions of this statement, share-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of share-based awards at the grant date requires judgment, including estimating expected dividends, estimating expected forfeiture rates, estimating expected stock volatility, estimating the expected term, estimating expected risk-free interest rates and determining illiquidity discount rates. If actual results differ significantly from these estimates and we materially change our estimates, stock-based compensation expense and our results of operations could be materially impacted.

We have elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the Code), commencing with our 1994 tax year. As a result, we are not subject to federal income taxes on the amount of our distributions, provided we distribute annually at least 90% of our taxable income to our stockholders and satisfy certain other requirements defined in the Code. Accordingly, no provision was made for federal income taxes in the accompanying consolidated financial statements.

***Comparison of Nine Months Ended September 30, 2006 to Nine Months Ended September 30, 2005***

Minimum rental income increased \$1,319,000, or 6%, to \$22,416,000 in 2006, compared to \$21,097,000 in 2005. The increase was the result of an increase of \$1,214,000 from the development and acquisition of six properties in 2005 and one property in 2006 and net rental increases of \$105,000 from existing tenants.

Percentage rental income remained relatively constant at \$41,000 in 2006 and \$39,000 in 2005.

Operating Cost Reimbursements decreased \$(37,000), or 2%, to \$2,060,000 in 2006, compared to \$2,097,000 in 2005.

Operating cost reimbursements decreased due to the net decrease in property operating expenses as explained below.

Other income increased \$13,000, to \$37,000 in 2006, compared to \$24,000 in 2005. The increase was the result of management fees earned during 2006.

Real estate taxes increased \$36,000, or 3%, to \$1,352,000 in 2006, compared to \$1,316,000 in 2005. The increase is the result of general assessment adjustments.

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Property operating expenses (shopping center maintenance, insurance and utilities) decreased \$(117,000), or 8%, to \$1,318,000 in 2006 compared to \$1,435,000 in 2005. The decrease was the result of decreased snow removal costs of \$(102,000); an increase in shopping center maintenance costs of \$33,000; a decrease in utility costs of \$(6,000); and a decrease in insurance costs of \$(42,000) in 2006 versus 2005.

Land lease payments remained constant at \$586,000 in 2006 and 2005.

General and administrative expenses increased by \$414,000, or 16%, to \$3,079,000 in 2006, compared to \$2,665,000 in 2005. The increase was the result of increased compensation related expenses as a result of salary increases and the addition of employees of \$260,000, increased professional fees and general taxes of \$332,000, a decrease in contracted services to investigate Florida development opportunities of \$(152,000) and decreased property related expenses of \$(26,000). General and administrative expenses as a percentage of total rental income increased from 12.6% for 2005 to 13.7% for 2006.

Depreciation and amortization increased \$157,000, or 5%, to \$3,618,000 in 2006, compared to \$3,461,000 in 2005.

The increase was the result of the development and acquisition of six properties in 2005 and one property in 2006.

Interest expense increased \$392,000, or 13%, to \$3,449,000 in 2006, from \$3,057,000 in 2005. The increase in interest expense resulted from increased borrowings to fund the development and acquisition of six properties in 2005 and one property in 2006, as well as overall interest rate increases.

Our income before minority interest and discontinued operations increased \$415,000, or 4%, to \$11,152,000 in 2006 from \$10,737,000 in 2005 as a result of the foregoing factors.

***Comparison of Three Months Ended September 30, 2006 to Three Months Ended September 30, 2005***

Minimum rental income increased \$391,000, or 6%, to \$7,453,000 in 2006, compared to \$7,062,000 in 2005. The increase was the result of an increase of \$335,000 from the development and acquisition of six properties in 2005 and one property in 2006 and net rental increases of \$56,000 from existing tenants.

Percentage rental income remained constant at \$14,000 in 2006 and 2005.

Operating Cost Reimbursements increased \$26,000, or 4%, to \$639,000 in 2006, compared to \$613,000 in 2005.

Operating cost reimbursements increased due to the increase in real estate taxes and property operating expenses as explained below.

Other income remained relatively constant at \$9,000 in 2006 and \$7,000 in 2005.

Real estate taxes increased \$6,000, or 1%, to \$450,000 in 2006, compared to \$444,000 in 2005. The increase is the result of general assessment adjustments.

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Property operating expenses (shopping center maintenance, insurance and utilities) increased \$47,000, or 14%, to \$389,000 in 2006 compared to \$342,000 in 2005. The increase was the result of an increase in shopping center maintenance costs of \$56,000; a decrease in utility costs of \$(4,000); and a decrease in insurance costs of \$(5,000) in 2006 versus 2005.

Land lease payments remained constant at \$195,000 in 2006 and 2005.

General and administrative expenses increased by \$94,000, or 10%, to \$1,006,000 in 2006, compared to \$912,000 in 2005. The increase was the result of increased professional fees and general taxes of \$108,000, increased contracted services to investigate development opportunities of \$35,000 and decreased property related expenses of \$(49,000). General and administrative expenses as a percentage of total rental income increased from 12.9% for 2005 to 13.5% for 2006.

Depreciation and amortization increased \$45,000, or 4%, to \$1,213,000 in 2006, compared to \$1,168,000 in 2005. The increase was the result of the development and acquisition of six properties in 2005 and one property in 2006.

Interest expense increased \$128,000, or 12%, to \$1,157,000 in 2006, from \$1,029,000 in 2005. The increase in interest expense resulted from increased borrowings to fund the development and acquisition of six properties in 2005 and one property in 2006, as well as overall interest rate increases.

Our income before minority interest and discontinued operations increased \$97,000, or 3%, to \$3,704,000 in 2006 from \$3,607,000 in 2005 as a result of the foregoing factors.

***Liquidity and Capital Resources***

Our principal demands for liquidity are distributions to our stockholders, debt repayment, development of new properties and future property acquisitions.

During the quarter ended September 30, 2006, we declared a quarterly dividend of \$.49 per share. The dividend was paid on October 12, 2006, to holders of record on September 29, 2006.

As of September 30, 2006, we had total mortgage indebtedness of \$48,914,021 with a weighted average interest rate of 6.64%. Future scheduled annual maturities of mortgages payable for the years ending September 30 are as follows: 2007 \$2,489,629; 2008 \$2,709,461; 2009 - \$2,889,198; 2010 \$3,086,187 and 2011 \$3,296,646. This mortgage debt is all fixed rate debt.

In addition, the Operating Partnership has in place a \$50 million credit facility with LaSalle Bank, as the agent (Credit Facility), which we guarantee. The Credit Facility matures in November 2006 and can be extended at our option for an additional three years. During the three year extension period, we will have no further ability to borrow under this facility and will be required to repay a portion of the unpaid principal on a quarterly basis. Advances under the Credit Facility bear interest within a range of one month to six month LIBOR plus 150 basis points to 213 basis points or the

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bank's prime rate, at our option, based on certain factors such as debt to property value and debt service coverage. The Credit Facility is used to fund property acquisitions and development activities and is secured by most of our properties which are not otherwise encumbered and properties to be acquired or developed. As of September 30, 2006 \$12,000,000 was outstanding under the Credit Facility bearing a weighted average interest rate of 6.78%.

We also have in place a \$5 million line of credit (Line of Credit), which matures in November 2006 and which we expect to extend for an additional one year period. The Line of Credit bears interest at the lender's prime rate less 50 basis points or 175 basis points in excess of the one-month LIBOR rate, at our option. The purpose of the Line of Credit is to provide us working capital and fund land options and start-up costs associated with new projects. As of September 30, 2006 \$3,650,000 was outstanding under the line of credit with a weighted average interest rate of 7.75%.

The following table outlines our contractual obligations (in thousands) as of September 30, 2006.

	<b>Total</b>	<b>Yr 1</b>	<b>2-3 Yrs</b>	<b>4-5 Yrs</b>	<b>Over 5 Yrs</b>
Mortgages Payable	\$ 48,914	\$ 2,490	\$ 5,598	\$ 6,383	\$ 34,443
Notes Payable	15,650	3,891	644	11,115	
Land Lease Obligation	13,052	768	1,535	1,547	9,202
Interest Payments on Mortgages and Notes Payable	27,339	4,231	7,461	5,253	10,394
Other Long-Term Liabilities					
<b>Total</b>	<b>\$ 104,955</b>	<b>\$ 11,380</b>	<b>\$ 15,238</b>	<b>\$ 24,298</b>	<b>\$ 54,039</b>

We have two development projects under construction that will add an additional 29,311 square feet of GLA to our portfolio. One project is expected to be completed during the fourth quarter of 2006 and the second project is expected to be completed during the second quarter of 2007. Additional funding required to complete the projects is estimated to be \$2,730,000 and will come from the Credit Facility.

We intend to meet our short-term liquidity requirements, including capital expenditures related to the leasing and improvement of the properties, through the cash flow provided by operations and 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. We may obtain additional funds for future development or acquisitions through other borrowings or the issuance of additional shares of common stock. We intend to incur additional debt in a manner consistent with our policy of maintaining a ratio of total debt (including construction and acquisition financing) to total market capitalization of 65% or less. 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 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.



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Part I*****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***

We consider Funds from Operations (FFO) to be a useful supplemental measure to evaluate our operating performance because, by excluding gains or losses on dispositions and excluding depreciation, FFO can help an investor compare the operating performance of our real estate between periods or compare such performance to that of different companies. 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 uses historical cost accounting is insufficient by itself.

FFO is defined by the National Association of Real Estate Investment Trusts, Inc. (NAREIT) to mean net income computed in accordance with GAAP, excluding gains (or losses) from sales of property, plus real estate related depreciation and amortization. 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. While we adhere to the NAREIT definition of FFO in making our calculation, our method of calculating FFO may not be comparable to the methods used by other REITs and accordingly may be different from similarly titled measures reported by other companies.

The following tables illustrate the calculation of FFO for the nine months and three months ended September 30, 2006 and 2005:

<i>Nine Months Ended September 30,</i>	<b>2006</b>	<b>2005</b>
Net income	<b>\$ 10,254,956</b>	\$ 10,274,487
Depreciation of real estate assets	<b>3,540,228</b>	3,521,149
Amortization of leasing costs	<b>32,241</b>	36,267
Gain on sale of fixed asset		(6,397)
Minority interest	<b>896,588</b>	915,704
<b>Funds from Operations</b>	<b>\$ 14,724,013</b>	\$ 14,741,210
<b>Weighted Average Shares and OP Units Outstanding    Dilutive</b>	<b>8,339,913</b>	8,233,865

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<i>Three Months Ended September 30,</i>	<b>2006</b>	<b>2005</b>
Net income	<b>\$ 3,406,127</b>	\$ 3,454,026
Depreciation of real estate assets	<b>1,185,432</b>	1,185,378
Amortization of leasing costs	<b>11,751</b>	12,089
Gain on sale of fixed asset		(6,397)
Minority interest	<b>297,797</b>	303,209
<b>Funds from Operations</b>	<b>\$ 4,901,107</b>	\$ 4,948,305
<b>Weighted Average Shares and OP Units Outstanding    Dilutive</b>	<b>8,346,096</b>	8,345,837

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to interest rate risk primarily through its 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 remaining debt, by year of expected maturity to evaluate the expected cash flows and sensitivity to interest rate changes.

	<i>Year Ended September 30,</i>						
	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>Thereafter</i>	<i>Total</i>
<b>Fixed rate debt</b>	2,490	2,709	2,889	3,086	3,297	34,443	<b>48,914</b>
<b>Average interest rate</b>	6.64	6.64	6.64	6.64	6.64	6.64	
<b>Variable rate debt</b>	3,891	322	322	11,115			<b>15,650</b>
<b>Average interest rate</b>	7.25	6.78	6.78	6.78			

The fair value (in thousands) is estimated at \$48,900 and \$15,650 for fixed rate debt and variable rate debt, respectively

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**Part I**

The table above incorporates those exposures that exist as of September 30, 2006; it does not consider those exposures or position, which could arise after that date. As a result, our ultimate realized gain or loss with respect to interest rate fluctuations will depend on the exposures that arise during the period and interest rates.

We do not enter into financial instruments transactions for trading or other speculative purposes or to manage interest rate exposure.

A 10% adverse change in interest rates on the portion of our debt bearing interest at variable rates would result in an increase in interest expense of approximately \$110,000.

**ITEM 4. CONTROLS AND PROCEDURES**

At December 31, 2005, management identified the following material weaknesses in our internal controls:

We lack segregation of duties in the period-end financial reporting process. Our Chief Financial Officer (CFO) is the only employee with any significant knowledge of generally accepted accounting principles.

The CFO is also the sole employee in charge of the general ledger (including the preparation of routine and non-routine journal entries and journal entries involving accounting estimates), the preparation of accounting reconciliations, the selection of accounting principles, and the preparation of interim and annual financial statements (including report combinations, consolidation entries and footnote disclosures) in accordance with generally accepted accounting principles.

We lack the expertise and resources to ensure complete application of generally accepted accounting principles to non-routine transactions. As a result of this material weakness, we recorded adjustments to our December 31, 2005 consolidated financial statements prior to the issuance of the statements. These adjustments affected other assets, unearned compensation, equity and general and administrative expenses.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act), as of the end of the period covered by this report.

Based on this evaluation as of September 30, 2006, and due to the material weaknesses in our internal control over financial reporting as described above, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were not effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms. There was no change in our internal control over financial reporting during the most recently completed fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Our audit committee has engaged independent third party consultants to perform periodic reviews of our financial reporting closing process.

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Part II**

**Part II Other Information**

**Item 1. Legal Proceedings**

None

**Item 1A. Risk Factors**

We do not have material changes to our risk factors set forth under Item 1A of Part I of our most recently filed Form 10-K.

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

None

**Item 3. Defaults Upon Senior Securities**

None

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

None

**Item 5. Other Information**

None

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**Agree Realty Corporation  
Part II**

**Item 6. Exhibits**

- 3.1 Articles of Incorporation and Articles of Amendment of the Company (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-11 (Registration Statement No. 33-73858, as amended (Agree S-11)))
- 3.2 Bylaws of the Company (incorporated by reference to Exhibit 3.3 to Agree S-11)
- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Richard Agree, Chief Executive Officer
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Kenneth R. Howe, Chief Financial Officer
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Richard Agree, Chief Executive Officer
- 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Kenneth R. Howe, Chief Financial Officer

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**Agree Realty Corporation  
Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has fully caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**Agree Realty Corporation**

/s/ RICHARD AGREE

Richard Agree  
President and Chief Executive Officer

/s/ KENNETH R. HOWE

Kenneth R. Howe  
Vice-President Finance and Secretary  
(Principal Financial Officer)

Date: November 7, 2006

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**EX. DESCRIPTION**

- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Richard Agree, Chief Executive Officer
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, Kenneth R. Howe, Chief Financial Officer
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Richard Agree, Chief Executive Officer
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