

AGREE REALTY CORP  
Form 10-K  
March 13, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K

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

For the fiscal year ended December 31, 2008

Commission File Number 1-12928

AGREE REALTY CORPORATION  
(Exact name of Registrant as specified in its charter)

Maryland  
(State or other jurisdiction of  
incorporation or organization)

38-3148187  
(I.R.S. Employer  
Identification No.)

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

48334  
(Zip code)

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

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$.0001 par value	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

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

Indicate by check mark whether the registrant is 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

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company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The aggregate market value of the Registrant’s shares of common stock held by non-affiliates was approximately \$173,435,000 as of June 30, 2008, based on the closing price of \$22.05 on the NYSE on that date.

At February 27, 2009, there were 7,931,030 shares of common stock, \$.0001 par value per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s proxy statement for the annual stockholder meeting to be held in 2009 are incorporated by reference into Part III of this Form 10-K.

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Part I

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 (Exchange Act). These forward-looking statements represent our expectations, plans or 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, reasonable assumptions and our best 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 Item 1A. “Risk Factors” and elsewhere in this report and in subsequent filings with the Securities and Exchange Commission. 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.

Item 1. BUSINESS

General

Agree Realty Corporation, a Maryland corporation, is a fully-integrated, self-administered and self-managed real estate investment trust (REIT). The terms “Registrant”, “Company”, “we”, “our” or “us” refer to Agree Realty Corporation and/or its majority owned operating partnership, Agree Limited Partnership (Operating Partnership), and/or its majority owned and controlled subsidiaries, including its qualified taxable REIT subsidiary (TRS), as the context may require. Our assets are held by and all of our operations are conducted through, directly or indirectly, the Operating Partnership, of which we are the sole general partner and in which we held a 92.85% interest as of December 31, 2008. Under the partnership agreement of the Operating Partnership, we, as the sole general partner, have exclusive responsibility and discretion in the management and control of the Operating Partnership. Our headquarters are located at 31850 Northwestern Highway, Farmington Hills, MI 48334 and our telephone number is (248) 737-4190.

The Company is focused primarily on the ownership, development, acquisition and management of retail properties net leased to national tenants. We were formed in December 1993 to continue and expand the business founded in 1971 by our current President, 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 December 31, 2008, approximately 89% of our annualized base rent was derived from national tenants. 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.

At December 31, 2008, our portfolio consisted of 68 properties, located in 16 states containing an aggregate of approximately 3.4 million square feet of gross leasable area (GLA). As of December 31, 2008, our portfolio included 56 freestanding net leased properties and 12 community shopping centers that were 99.2% leased with a weighted average lease term of approximately 10.6 years remaining. As of December 31, 2008, approximately 68% of our annualized base rent was derived from our top three tenants: Borders Group, Inc. (Borders) – 30%, Walgreen Co. (Walgreen) – 26% and Kmart Corporation (Kmart) - 12%. See Item 2. “Properties” for a summary of our developments

and acquisitions in 2008, as well as other information regarding our tenants, leases and properties as of December 31, 2008.

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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 our 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 risk associated with speculative development. Since our initial public offering in 1994, we have developed 55 of our 68 properties, including 43 of our 56 freestanding properties and all 12 of our community shopping centers. As of December 31, 2008, the properties that we developed accounted for approximately 85% of our annualized base rent. We expect to continue to expand our tenant relationships and diversify our tenant base to include other quality national tenants.

### Growth Strategy

**Development.** Our growth strategy is to develop retail properties pre-leased on a long-term basis to national tenants. We believe that this strategy produces superior risk adjusted returns. Our development process commences with the identification of a land parcel we believe is situated in an attractive retail location. The location must be in a concentrated retail corridor and have high traffic counts, good visibility and demographics compatible with the needs of a particular retail tenant. After assessing the feasibility of development, we propose to the tenants that we execute long-term net leases for the finished development on that site.

Upon the execution of the leases, we purchase the land and pursue all the necessary approvals to begin development. We direct all aspects of the development, including construction, design, leasing and management. Property management and the majority of the leasing activities are handled directly by our personnel. We believe that this approach enhances our ability to maximize the long-term value of our properties and results in an efficient use of our capital resources.

**Acquisitions.** We selectively acquire single tenant properties when we have determined that a potential acquisition meets our return on investment criteria and such acquisition will diversify our rental income.

### Financing Strategy

The majority of our mortgage indebtedness is fixed rate, non-recourse and long-term in nature. Whenever feasible, we enter into long-term financing for our properties to match the underlying long-term leases. As of December 31, 2008, the average weighted maturity of our long-term debt was 8.5 years. We intend to limit our floating rate debt to borrowings under our credit facilities, which are primarily used to finance new development and acquisitions. Once development of a project is completed, we typically consider refinancing this floating rate debt with fixed rate, non-recourse debt. As of December 31, 2008, our total debt was approximately \$100.6 million, consisting of approximately \$43.0 million of fixed rate debt with a weighted average interest rate of 6.64%, and \$66.6 million of floating rate debt, consisting of a mortgage in the amount of \$24.6 million that bears interest at 150 basis points over LIBOR (2.695% as of December 31, 2008) and the credit facilities, at a weighted average interest rate of 2.82%. We intend to maintain a ratio of total indebtedness (including construction and acquisition financing) to market capitalization of 65% or less. At December 31, 2008, our ratio of indebtedness to market capitalization assuming the conversion of our operating partnership units, was approximately 65.4%. The increase in our ratio of indebtedness to market capitalization from 2007 to 2008 was primarily the result of a significant decline in the market price of our common stock.

We are evaluating our borrowing policies on an on-going basis in light of current economic conditions, relative costs of debt and equity capital, market value of properties, growth and acquisition opportunities and other factors. There is no contractual limit or any limit in our organizational documents on our ratio of total indebtedness to total market capitalization, and accordingly, we may modify our borrowing policy and may increase or decrease our ratio of debt to market capitalization without stockholder approval.

## Property Management

We maintain a proactive leasing and capital improvement program that, combined with the quality and locations of our properties, has made our properties attractive to tenants. We intend to continue to hold our properties for long-term investment and, accordingly, place a strong emphasis on quality construction and an on-going program of regular maintenance. Our properties are designed and built to require minimal capital improvements other than renovations or expansions paid for by tenants. At our 12 community shopping centers properties, we sub-contract on-site functions such as maintenance, landscaping, snow removal and sweeping and the cost of these functions is generally reimbursed by our tenants. Personnel from our corporate headquarters conduct regular inspections of each property and maintain regular contact with major tenants.

We have a management information system designed to provide management with the operating data necessary to make informed business decisions on a timely basis. This computer system provides us rapid access to store availability, lease data, tenants' sales history, cash flow budgets and forecasts, and enables us to maximize cash flow from operations and closely monitor corporate expenses.

#### Major Tenants

As of December 31, 2008, approximately 68% of our gross leasable area was leased to Borders, Walgreen, and Kmart and approximately 68% of our total annualized base rents was attributable to these tenants. At December 31, 2008, Borders occupied approximately 28% of our gross leasable area and accounted for approximately 30% of the annualized base rent. At December 31, 2008, Walgreen occupied approximately 10% of our gross leasable area and accounted for approximately 26% of the annualized base rent. At December 31, 2008, Kmart occupied approximately 29% of our gross leasable area and accounted for approximately 12% of the annualized base rent. No other tenant accounted for more than 10% of gross leasable area or annualized base rent in 2008. The loss of any of these anchor tenants or a significant number of their stores, or the inability of any of them to pay rent, would have a material adverse effect on our business.

#### Tax Status

We have operated and intend to operate in a manner to qualify as a REIT under Sections 856 through 860 of the Internal Revenue Code. In order to maintain qualification as a REIT, we must, among other things, distribute at least 90% of our REIT income and meet certain other asset and income tests. Additionally, our charter limits ownership of the Company, directly or constructively, by any single person to 9.8% of the total number of outstanding shares, subject to certain exceptions. As a REIT, we are not subject to federal income tax with respect to that portion of our income that meets certain criteria and is distributed annually to the stockholders.

In October 2007, we established a taxable REIT subsidiary (the "TRS") pursuant to the provisions of the REIT Modernization Act. Our TRS is 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 activities of the Company which occur within its TRS entity are subject to federal and state income taxes.

#### Competition

The United States commercial real estate investment market continues to be highly competitive. We actively compete with many other entities engaged in the development, acquisition and operation of commercial properties. As such, we compete for a limited supply of properties and financing for these properties. Investors include large institutional investors, insurance companies, credit companies, pension funds, private individuals, investment companies and other REITs, many of which have greater financial and other resources than we do. There can be no assurance that we will be able to compete successfully with such entities in our development, acquisition and leasing activities in the future.

#### Potential Environmental Risks

Investments in real property create a potential for environmental liability on the part of the owner or operator of such real property. If hazardous substances are discovered on or emanating from a property, the owner or operator of the property may be held strictly liable for all costs and liabilities relating to such hazardous substances. We have obtained a Phase I environmental study (which involves inspection without soil sampling or ground water analysis) conducted on each of our properties by independent environmental consultants. Furthermore, we have adopted a policy of conducting a Phase I environmental study on each property we acquire and if necessary conducting additional investigation as warranted.





We conducted Phase I environmental studies on the properties we developed in 2008. The results of these Phase I studies indicated that no further action was required on any of the properties, including no further soil sampling or ground water analysis. In addition, we have no knowledge of any hazardous substances existing on any of our properties in violation of any applicable laws; however, no assurance can be given that such substances are not located on any of the properties. We carry no insurance coverage for the types of environmental risks described above.

We believe that we are in compliance, in all material respects, with all federal, state and local ordinances and regulations regarding hazardous or toxic substances. Furthermore, we have not been notified by any governmental authority of any noncompliance, liability or other claim in connection with any of the properties.

#### Employees

As of February 27, 2009, we employed eleven persons. Employee responsibilities include accounting, construction, leasing, property coordination and administrative functions for the properties. Our employees are not covered by a collective bargaining agreement, and we consider our employee relations to be satisfactory.

#### Financial Information About Industry Segments

We are in the business of development, acquisition and management of freestanding net leased properties and community shopping centers. We consider our activities to consist of a single industry segment. See the Consolidated Financial Statements and Notes thereto included in this Annual Report on Form 10-K.

#### Available Information

Our headquarters are located at 31850 Northwestern Highway, Farmington Hills, MI 48334 and our telephone number is (248) 737-4190. Our web site address is [www.agreerealty.com](http://www.agreerealty.com). Agree Realty Corporation's reports electronically filed with or furnished to the SEC can be accessed through this site, free of charge, as soon as reasonably practicable after we electronically file or furnish such reports. These filings are also available on the SEC's website at [www.sec.gov](http://www.sec.gov).

#### ITEM 1A.

#### RISK FACTORS

##### General

We rely significantly on three major tenants. As of December 31, 2008, we derived approximately 68% of our annualized base rent from three major tenants, Borders, Walgreen and Kmart. In the event of a default by any of these tenants under their leases, we may experience delays in enforcing our rights as lessor and may incur substantial costs in protecting our investment. In addition, a significant portion of our 2008 development projects were for Walgreen. The bankruptcy or insolvency of any of the major tenants would likely have a material adverse effect on the properties affected and the income produced by those properties and correspondingly our ability to make distributions.

We could be adversely affected by a tenant's bankruptcy. If a tenant becomes bankrupt or insolvent, that could diminish the income we receive from that tenant's leases. We may not be able to evict a tenant solely because of its bankruptcy. On the other hand, a bankruptcy court might authorize the tenant to terminate its leases with us. If that happens, our claim against the bankrupt tenant for unpaid future rent would be an unsecured prepetition claim subject to statutory limitations, and therefore such amounts received in bankruptcy are likely to be substantially less than the remaining rent we otherwise were owed under the leases. In addition, any claim we have for unpaid past rent could be substantially less than the amount owed. Circuit City, a tenant who occupies one location in our portfolio filed for bankruptcy protection in December 2008 and is in the process of liquidation.



Risks involved in single tenant leases. We focus our development activities on net leased real estate or interests therein. Because our properties are generally leased to single tenants, the financial failure of or other default by a tenant resulting in the termination of a lease is likely to cause a significant reduction in our operating cash flow and might decrease the value of the property leased to such tenant. We may also experience difficulty and/or a significant delay in re-leasing such property.

Risks associated with borrowing, including loss of properties in the event of a foreclosure. At December 31, 2008, our ratio of indebtedness to market capitalization (assuming conversion of Operating Partnership units) was approximately 65.4%. This ratio increased from 32.5% in 2007 as a result of a significant decline in the market value of our common stock. The use of leverage presents an additional element of risk in the event that (1) the cash flow from lease payments on our properties is insufficient to meet debt obligations, (2) we are unable to refinance our debt obligations as necessary or on as favorable terms or (3) there is an increase in interest rates. If a property is mortgaged to secure payment of indebtedness and we are unable to meet mortgage payments, the property could be foreclosed upon with a consequent loss of income and asset value to us. Under the "cross-default" provisions contained in mortgages encumbering some of our properties, our default under a mortgage with a lender would result in our default under mortgages held by the same lender on other properties resulting in multiple foreclosures.

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. Our organization documents contain no limitation on the amount or percentage of indebtedness which we may incur. Therefore, our board of directors, without a vote of the stockholders, could alter the general policy on borrowings at any time. If our debt capitalization policy were changed, we could become more highly leveraged, resulting in an increase in debt service that could adversely affect our operating cash flow and our ability to make expected distributions to stockholders, and could result in an increased risk of default on our obligations.

Risks associated with our development and acquisition activities. We intend to continue development of new properties and to consider possible acquisitions of existing properties. We anticipate that our new developments will be financed under lines of credit or other forms of construction financing that will result in a risk that permanent financing on newly developed projects might not be available or would be available only on disadvantageous terms. In addition, new project development is subject to a number of risks, including risks of construction delays or cost overruns that may increase project costs, risks that the properties will not achieve anticipated occupancy levels or sustain anticipated rent levels, and new project commencement risks such as receipt of zoning, occupancy and other required governmental permits and authorizations and the incurrence of development costs in connection with projects that are not pursued to completion. If permanent debt or equity financing are not available on acceptable terms to refinance new development or acquisitions undertaken without permanent financing, further development activities or acquisitions might be curtailed or cash available for distribution might be adversely affected. Acquisitions entail risks that investments will fail to perform in accordance with expectations and that judgments with respect to the costs of improvements to bring an acquired property up to standards established for the market position intended for that property will prove inaccurate, as well as general investment risks associated with any new real estate investment.

The recent global economic and financial market crisis has had and may continue to have a negative effect on our business and operations. The recent global economic and financial market crisis has caused, among other things, a general tightening in the credit markets, lower levels of liquidity, increases in the rates of default and bankruptcy, lower consumer and business spending, and lower consumer confidence and net worth, all of which has had and may continue to have a negative effect on our business, results of operations, financial condition and liquidity. Many of our tenants have been affected by the current economic turmoil. Current or potential tenants may delay or postpone entering into long-term net leases with us which could continue to lead to reduced demand for commercial real estate. We are also limited in our ability to reduce costs to offset the results of a prolonged or severe economic downturn given certain fixed costs and commitments associated with our operations.

The timing and nature of any recovery in the credit and financial markets remains uncertain, and there can be no assurance that market conditions will improve in the near future or that our results will not continue to be materially and adversely affected. Such conditions make it very difficult to forecast operating results, make business decisions and identify and address material business risks. The foregoing conditions may also impact the valuation of certain long-lived or intangible assets that are subject to impairment testing, potentially resulting in impairment charges which may be material to our financial condition or results of operations.

Capital markets are currently experiencing a period of dislocation and instability, which has had and could continue to have a negative impact on the availability and cost of capital. The general disruption in the U.S. capital markets has impacted the broader worldwide financial and credit markets and reduced the availability of debt and equity capital for the market as a whole. These conditions could persist for a prolonged period of time or worsen in the future. Our ability to access the capital markets may be restricted at a time when we would like, or need, to access those markets, which could have an impact on our flexibility to react to changing economic and business conditions. The resulting lack of available credit, lack of confidence in the financial sector, increased volatility in the financial markets and reduced business activity could materially and adversely affect our business, financial condition, results of operations and our ability to obtain and manage our liquidity. In addition, the cost of debt financing and the proceeds of equity financing may be materially adversely impacted by these market conditions.

Credit market developments may reduce availability under our credit agreements. Due to the current volatile state of the credit markets, there is risk that lenders, even those with strong balance sheets and sound lending practices, could fail or refuse to honor their legal commitments and obligations under existing credit commitments, including but not limited to: extending credit up to the maximum permitted by a credit facility, allowing access to additional credit features and/or honoring loan commitments. If our lender(s) fail to honor their legal commitments under our credit facilities, it could be difficult in the current environment to replace our credit facilities on similar terms. Although we believe that our operating cash flow and existing credit facilities will give us the ability to satisfy our liquidity needs for at least the next 12 months, the failure of any of the lenders under our credit facility may impact our ability to finance our operating or investing activities.

Our portfolio has limited geographic diversification. Our properties are located primarily in the Midwestern United States and in particular, Michigan (with 39 properties). The concentration of our properties in a limited number of geographic regions creates the risk that, should these regions experience an economic difficulties relative to other regions, our operations may be adversely affected in comparison to other real estate companies with properties in such other regions.

Certain of our tenants at our community shopping centers have the right to terminate their leases if other tenants cease to occupy a property. In the event that certain tenants cease to occupy a property, although under most circumstances such a tenant would remain liable for its lease payments, such an action may result in certain other tenants at our community shopping centers having the right to terminate their leases at the affected property, which could adversely affect the future income from that property. As of December 31, 2008, each of our 12 community shopping centers had tenants with those provisions in their leases.

Dependence on key personnel. We are dependent on the efforts of our executive officers. The loss of one or more of our executive officers would likely have a material adverse effect on our future development or acquisition operations, which could adversely affect the market price of our common stock. We do not presently have key-man life insurance for any of our employees.

We can change our investment and financing policies without stockholder approval. Our investment and financing policies, and our policies with respect to certain other activities, including our growth, debt capitalization, distributions, REIT status and investment and operating policies, are determined by our board of directors. Although we have no present intention to do so, these policies may be amended or revised from time to time at the discretion of our board of directors without a vote of our stockholders.

Competition. We face competition in seeking properties for acquisition and tenants who will lease space in these properties from insurance companies, credit companies, pension funds, private individuals, investment companies and other REITs, many of which have greater financial and other resources than we do. There can be no assurance that the Company will be able to successfully compete with such entities in its development, acquisition and leasing activities in the future.



## Risks Associated With Investment in Real Estate

There are risks associated with owning and leasing real estate. Although our lease terms obligate the tenants to bear substantially all of the costs of operating our properties, investing in real estate involves a number of risks, including:

- The risk that tenants will not perform under their leases, reducing our income from the leases or requiring us to assume the cost of performing obligations (such as taxes, insurance and maintenance) that are the tenant's responsibility under the lease.
- The risk that changes in economic conditions or real estate markets may adversely affect the value of our properties.
- The risk that local conditions (such as oversupply of similar properties) could adversely affect the value of our properties.
  - The risk that we may not always be able to lease properties at favorable rental rates.
  - The risk that we may not always be able to sell a property when we desire to do so at a favorable price.
  - The risk of changes in tax, zoning or other laws could make properties less attractive or less profitable.

The current global economic and financial market crisis has exacerbated many of the foregoing risks. If a tenant fails to perform on its lease covenants, that would not excuse us from meeting any mortgage debt obligation secured by the property and could require us to fund reserves in favor of our mortgage lenders, thereby reducing funds available for payment of cash dividends on our shares of common stock.

Uncertainties relating to lease renewals and re-letting of space. We are subject to the risks that, upon expiration of leases for space located in our properties, the premises may not be re-let or the terms of re-letting (including the cost of concessions to tenants) may be less favorable than current lease terms. If a tenant does not renew its lease or if a tenant defaults on its lease obligations, there is no assurance we could obtain a substitute tenant on acceptable terms. If we cannot obtain another tenant with comparable structural needs, we may be required to modify the property for a different use, which may involve a significant capital expenditure and a delay in re-leasing the property. Further, if we are unable to re-let promptly all or a substantial portion of our retail space or if the rental rates upon such re-letting were significantly lower than expected rates, our net income and ability to make expected distributions to stockholders would be adversely affected. There can be no assurance that we will be able to retain tenants in any of our properties upon the expiration of their leases.

Some potential losses are not covered by insurance. Our leases require the tenants to carry comprehensive liability, casualty, workers' compensation, extended coverage and rental loss insurance on our properties. However, there are some types of losses, such as environmental liabilities, terrorist acts or catastrophic acts of nature, for which we or our tenants cannot obtain insurance at an acceptable cost. If there is an uninsured loss or a loss in excess of insurance limits, we could lose both the revenues generated by the affected property and the capital we have invested in the property. We believe the required coverage is of the type, and amount, customarily obtained by an owner of similar properties. We believe all of our properties are adequately insured. In the event of a substantial unreimbursed loss, we would, nevertheless, remain obligated to repay any mortgage indebtedness or other obligations related to the property.

Potential liability for environmental contamination could result in substantial costs. Under federal, state and local environmental laws, we may be required to investigate and clean up any release of hazardous or toxic substances or petroleum products at our properties, regardless of our knowledge or actual responsibility, simply because of our current or past ownership or operation of the real estate. If unidentified environmental problems arise, we may have



to make substantial payments, which could adversely affect our cash flow and our ability to make distributions to our stockholders. This potential liability results from the following:

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- As owner we may have to pay for property damage and for investigation and clean-up costs incurred in connection with the contamination.
- The law may impose clean-up responsibility and liability regardless of whether the owner or operator knew of or caused the contamination.
- Even if more than one person is responsible for the contamination, each person who shares legal liability under environmental laws may be held responsible for all of the clean-up costs.
- Governmental entities and third parties may sue the owner or operator of a contaminated site for damages and costs.

These costs could be substantial and in extreme cases could exceed the value of the contaminated property. The presence of hazardous substances or petroleum products or the failure to properly remediate contamination may adversely affect our ability to borrow against, sell or lease an affected property. In addition, some environmental laws create liens on contaminated sites in favor of the government for damages and costs it incurs in connection with a contamination.

Our leases require our tenants to operate the properties in compliance with environmental laws and to indemnify us against environmental liability arising from the operation of the properties. However, we could be subject to strict liability under environmental laws because we own the properties. There is also a risk that tenants may not satisfy their environmental compliance and indemnification obligations under the leases. Any of these events could substantially increase our cost of operations, require us to fund environmental indemnities in favor of our secured lenders and reduce our ability to service our secured debt and pay dividends to stockholders and any debt security interest payments. Environmental problems at any properties could also put us in default under loans secured by those properties, as well as loans secured by unaffected properties.

Real estate investments are relatively illiquid. We may desire to sell a property in the future because of changes in market conditions or poor tenant performance or to avail ourselves of other opportunities. We may also be required to sell a property in the future to meet secured debt obligations or to avoid a secured debt loan default. Real estate projects cannot always be sold quickly, and we cannot assure you that we could always obtain a favorable price, especially in light of the current global economic and financial market crisis. We may be required to invest in the restoration or modification of a property before we can sell it.

#### Tax Risks

We will be subject to increased taxation if we fail to qualify as a REIT for federal income tax purposes. Although we believe that we are organized and operate in such a manner so as to qualify as a REIT under the Internal Revenue Code of 1986, as amended (the Code), no assurance can be given that we will remain so qualified. Qualification as a REIT involves the application of highly technical and complex Code provisions for which there are only limited judicial or administrative interpretations. The complexity of these provisions and applicable Treasury Regulations is also increased in the context of a REIT that holds its assets in partnership form. The determination of various factual matters and circumstances not entirely within our control may affect our ability to qualify as a REIT. A REIT generally is not taxed at the corporate level on income it distributes to its stockholders, as long as it distributes annually at least 100% of its taxable income to its stockholders. We have not requested and do not plan to request a ruling from the Internal Revenue Service that we qualify as a REIT.

If we fail to qualify as a REIT, we will face tax consequences that will substantially reduce the funds available for payment of cash dividends:

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We would not be allowed a deduction for dividends paid to stockholders in computing our taxable income and would be subject to federal income tax at regular corporate rates.

- We could be subject to the federal alternative minimum tax and possibly increased state and local taxes.
- Unless we are entitled to relief under statutory provisions, we could not elect to be treated as a REIT for four taxable years following the year in which we were disqualified.

In addition, if we fail to qualify as a REIT, we will no longer be required to pay dividends (other than any mandatory dividends on any preferred shares we may offer). As a result of these factors, our failure to qualify as a REIT could adversely effect the market price for our common stock.

Excessive non-real estate asset values may jeopardize our REIT status. In order to qualify as a REIT, at least 75% of the value of our assets must consist of investments in real estate, investments in other REITs, cash and cash equivalents, and government securities. Therefore, the value of any property that is not considered a real estate asset for federal income tax purposes must represent in the aggregate less than 25% of our total assets. In addition, under federal income tax law, we may not own securities in any one company (other than a REIT, a qualified REIT subsidiary or a taxable REIT subsidiary) which represent in excess of 10% of the voting securities or 10% of the value of all securities of any one company, or which have, in the aggregate, a value in excess of 5% of our total assets, and we may not own securities of one or more taxable REIT subsidiaries which have, in the aggregate, a value in excess of 20% of our total assets. We may invest in securities of another REIT, and our investment may represent in excess of 10% of the voting securities or 10% of the value of the securities of the other REIT. If the other REIT were to lose its REIT status during a taxable year in which our investment represented in excess of 10% of the voting securities or 10% of the value of the securities of the other REIT as of the close of a calendar quarter, we will lose our REIT status.

The 25%, 20%, 10% and 5% tests are determined at the end of each calendar quarter. Subject to certain mitigation provisions, if we fail to meet any such test at the end of any calendar quarter, we will cease to qualify as a REIT.

We may have to borrow funds or sell assets to meet our distribution requirements. Subject to some adjustments that are unique to REITs, a REIT generally must distribute 90% of its taxable income. For the purpose of determining taxable income, we may be required to accrue interest, rent and other items treated as earned for tax purposes but that we have not yet received. In addition, we may be required not to accrue as expenses for tax purposes some items which actually have been paid, including, for example, payments of principal on our debt, or some of our deductions might be disallowed by the Internal Revenue Service. As a result, we could have taxable income in excess of cash available for distribution. If this occurs, we may have to borrow funds or liquidate some of our assets in order to meet the distribution requirement applicable to a REIT.

We may be subject to other tax liabilities. Even if we qualify as a REIT, we may be subject to some federal, state and local taxes on our income and property that could reduce operating cash flow.

Changes in tax laws may prevent us from qualifying as a REIT. As we have previously described, we intend to qualify as a REIT for federal income tax purposes. However, this intended qualification is based on the tax laws that are currently in effect. We are unable to predict any future changes in the tax laws that would adversely affect our status as a REIT. If there is a change in the tax laws that prevents us from qualifying as a REIT or that requires REITs generally to pay corporate level income taxes, we may not be able to make the same level of distributions to our stockholders.

#### ITEM 1B.

#### UNRESOLVED STAFF COMMENTS

None

## ITEM 2.

## PROPERTIES

Our properties consist of 56 freestanding net leased properties and 12 community shopping centers, that as of December 31, 2008 were 99.2% leased, with a weighted average lease term of 10.6 years. Approximately 89% of our annualized base rent was attributable to national retailers. Among these retailers are Borders, Walgreen and Kmart which, at December 31, 2008, collectively represented approximately 68% of our annualized base rent. A majority of our properties were built for or are leased to national tenants who require a high quality location with strong retail characteristics. We developed 43 of our 56 freestanding properties and all 12 of our community shopping centers. Five of our freestanding properties were acquired as part of our relationship with Borders. Properties we have developed (including our community shopping centers) account for approximately 85% of our annualized base rent as of December 31, 2008. Our 56 freestanding properties are comprised of 55 retail locations and Borders' corporate headquarters. See Notes 3 and 4 to the Consolidated Financial Statements included herein for information regarding mortgage debt and other debt related to our properties.

A substantial portion of our income consists of rent received under net leases. Most of the leases provide for the payment of fixed base rentals monthly in advance and for the payment by tenants of a pro rata share of the real estate taxes, insurance, utilities and common area maintenance of the shopping center as well as payment to us of a percentage of the tenant's sales. We received percentage rents of \$15,396, \$37,111 and \$53,550 for the fiscal years 2008, 2007 and 2006, respectively, and these amounts represented 0.1%, 0.1% and 0.2%, respectively, of our total revenue for these periods. Included in those amounts were percentage rents from Kmart of \$-0-, \$10,221 and \$13,695 for fiscal years 2008, 2007 and 2006, respectively. Leases with Borders do not contain percentage rent provisions. Leases with Walgreen do contain percentage rent provisions; however, no percentage rent was received from Walgreen during these periods. Some of our leases require us to make roof and structural repairs, as needed.

## Development and Acquisition Summary

During 2008, we completed the following developments and redevelopments:

Tenant(s)	Location	Cost
Walgreen (drug store)/Chase (retail bank)	Macomb Township, Michigan	\$6.1 million
Walgreen (drug store)	Ypsilanti, Michigan	\$4.9 million
Walgreen (drug store)	Shelby Township, Michigan	\$2.6 million
Walgreen (drug store)	Marion County, Florida	\$3.1 million
MC Sporting Goods and Peebles (redevelopment)	Big Rapids, Michigan	\$1.8 million

During 2008, we commenced the following developments:

Tenant(s)	Location	Budgeted Cost	Anticipated Completion
Walgreen (drug store)	Marion County, Florida	\$4.8 million	First quarter 2009
Walgreen (drug store)	Brighton, Michigan	\$4.1 million	First quarter 2009
Walgreen (drug store)	Brevard County, Florida	\$4.8 million	Second quarter 2009
Walgreen (drug store)	Lowell, Michigan	\$3.6 million	Third quarter 2009

We did not complete or commence any acquisitions in 2008. We did not sell any properties in 2008.

## Major Tenants

The following table sets forth certain information with respect to our major tenants:

	Number of Leases	Annualized Base Rent as of December 31, 2008	Percent of Total Annualized Base Rent as of December 31, 2008
Borders	18	\$ 9,957,608	30%
Walgreen	24	8,774,599	26
Kmart	12	3,847,911	12
Total	54	\$ 22,580,118	68%

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Borders Group, Inc. trades on the New York Stock Exchange under the symbol “BGP”. Borders is the second largest operator of book, music and movie superstores and the largest operator of mall-based bookstores in the world based upon both sales and number of stores. At February 2, 2008, the Company operated 541 superstores under the Borders name, including 509 in the United States. The Company also operated 490 mall-based and other bookstores, including stores operated under the Waldenbooks, Borders Express and Borders Outlet names as well as Borders-branded airport stores. Borders employed approximately 29,500 people worldwide as of such date. Borders has reported that its annual revenues for its 2007 fiscal year ended February 2, 2008 were approximately \$3.8 billion, its annual net (loss) for 2007 was approximately (\$157 million) and its total stockholders’ equity at fiscal year end 2007 was approximately of \$477 million.

Walgreen is a leader of the U.S. chain drugstore industry and trades on the New York Stock Exchange under the symbol “WAG”. Walgreen operated 6,934 locations in 49 states, the District of Columbia, Puerto Rico and Guam and had total assets of approximately \$22.4 billion as of August 31, 2008. As of January 21, 2009, Walgreen’s long-term debt had a Standard and Poor’s rating of A+ and a Moody’s rating of A2. For its fiscal year ended August 31, 2008, Walgreen reported that its annual net sales were \$59.0 billion, its annual net income was \$2.2 billion and it had shareholders’ equity of \$12.9 billion.

Kmart is a mass merchandising company that offers customers quality products through a portfolio of brands and labels. As of November 1, 2008, Kmart operated approximately 1,400 stores across 49 states, Guam, Puerto Rico and the U.S. Virgin Islands. Kmart is a wholly-owned subsidiary of Sears Holdings Corporation (Sears), which trades on the Nasdaq stock market under the symbol “SHLD”. Sears is a broadline retailer with approximately 2,300 full-line and 1,200 specialty retail stores in the United States operating through Kmart and Sears and approximately 380 full-line and specialty retail stores in Canada operating through Sears Canada, Inc. (Sears Canada), a 72%-owned subsidiary. As of November 1, 2008, Sears had total assets of \$28.0 billion, total liabilities of \$18.1 billion and shareholders equity of \$9.9 billion. All of our Kmart properties are in the traditional Kmart format and these Kmart properties average 85,000 square feet per property.

The financial information set forth above with respect to Borders, Walgreen and Kmart was derived from the annual reports on Form 10-K filed by Borders and Walgreen with the SEC with respect to their 2007 fiscal years and the quarterly report on form 10-Q filed by Sears Holdings Corporation with the SEC with respect to the third quarter of 2008. Additional information regarding Borders, Walgreen or Kmart may be found in their respective public filings. These filings can be accessed at [www.sec.gov](http://www.sec.gov). We are unable to confirm, and make no representations with respect to, the accuracy of these reports and therefore you should not place undue reliance on such information as it pertains to the Company’s operations.

#### Location of Properties in the Portfolio

State	Number of Properties	Total Gross Leasable Area (Sq. feet)	Percent of GLA Leased on December 31, 2008
California	1	38,015	100%
Florida	5	273,613	100
Georgia	1	14,820	100
Illinois	1	20,000	100
Indiana	2	15,844	100
Kansas	2	45,000	100
Kentucky	1	116,212	100
Maryland	2	53,000	100
Michigan	39	2,097,984	99

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Nebraska	2	55,000	100
New Jersey	1	10,118	100
New York	2	27,626	100

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State	Number of Properties	Total Gross Leasable Area (Sq. feet)	Percent of GLA Leased on December 31, 2008
Ohio	1	21,000	100
Oklahoma	4	99,282	100
Pennsylvania	1	28,604	100
Wisconsin	3	523,036	99
Total/Average	68	3,439,154	99%

#### Lease Expirations

The following table shows lease expirations for our community shopping centers and wholly-owned freestanding properties, assuming that none of the tenants exercise renewal options.

Expiration Year	December 31, 2008				
	Number of Leases Expiring	Gross Leasable Area		Annualized Base Rent	
		Square Footage	Percent Of Total	Amount	Percent Of Total
2009	14	203,685	6.0%	\$ 908,058	2.7%
2010	22	312,757	9.2%	1,869,226	5.6%
2011	28	235,834	6.9%	1,739,358	5.3%
2012	15	78,660	2.3%	626,599	1.9%
2013	19	316,613	9.3%	1,726,197	5.2%
2014	5	179,358	5.3%	873,006	2.6%
2015	12	653,042	19.1%	4,681,462	14.1%
2016	5	80,945	2.4%	1,664,513	5.0%
2017	3	22,844	0.7%	312,807	0.9%
2018	13	240,032	7.0%	4,371,681	13.2%
Thereafter	39	1,088,011	31.8%	14,351,860	43.5%
Total	175	3,411,781	100.0%	\$ 33,124,767	100.0%

We have made preliminary contact with the 14 tenants whose leases expire in 2009. Of those tenants, seven tenants, at their option, have the right to extend their lease term and seven tenants have leases expiring in 2009. We expect two tenants, including our only Circuit City store, to terminate their leases in 2009 and 12 tenants to extend their leases or enter into lease extensions.

## Annualized Base Rent of our Properties

The following is a breakdown of base rents in place at December 31, 2008 for each type of retail tenant:

Type of Tenant	Annualized Base Rent	Percent of Annualized Base Rent
National(1)	\$ 29,358,646	89%
Regional(2)	2,640,792	8
Local	1,125,329	3
Total	\$ 33,124,767	100%

(1)Includes the following national tenants: Borders, Walgreen, Kmart, Wal-Mart, Eckerd Drugs, Fashion Bug, Rite Aid, JC Penney, Avco Financial, GNC Group, Radio Shack, Super Value, Maurices, Payless Shoes, Blockbuster Video, Family Dollar, H&R Block, Sally Beauty, Jo Ann Fabrics, Staples, Best Buy, Dollar Tree, TGI Friday's, Circuit City and Pier 1 Imports.

(2)Includes the following regional tenants: Roundy's Foods, Dunham's Sports, Christopher Banks and Beall's Department Stores.

## Freestanding Properties

56 of our properties are freestanding properties which at December 31, 2008 were leased to Walgreen (23), Borders (18), Rite Aid (5), Kmart (2), Eckerd Drugs (2), Circuit City Stores (1), Fajita Factory (1), Citizens Bank (1), Lake Lansing RA Associates, LLC (1), Meijer (1) and Wal-Mart (Sam's Club) (1). Our freestanding properties provided \$22,839,459, or approximately 68.9%, of our annualized base rent as of December 31, 2008, at an average base rent per square foot of \$14.50. These properties contain, in the aggregate, 1,576,498 square feet of gross leasable area or approximately 46.0% of our total gross leasable area as of December 31, 2008. Our freestanding properties tend to have high traffic counts, are generally located in densely populated areas and are leased to a single tenant on a long term basis. Forty-three (43) of our 56 freestanding properties were developed by us. Five of our 56 freestanding properties, although not developed by us, were acquired as part of our relationship with Borders. As of December 31, 2008, our freestanding properties have a weighted average lease term of 13.1 years.

Our freestanding properties range in size from 4,426 to 458,729 square feet of gross leasable area and are located in the following states: California (1), Florida (4), Georgia (1), Indiana (2), Kansas (2), Maryland (2), Michigan (33), Nebraska (2), New Jersey (1), New York (2), Ohio (1), Oklahoma (4) and Pennsylvania (1).

## Freestanding Properties

Tenant/Location	Year Completed/ Expanded	Total GLA	Lease Expiration(2) (Option expiration)
Borders, Aventura, FL (1)	1996	30,000	Jan 31, 2016 (2036)
Borders, Columbus, OH	1996	21,000	Jan 23, 2016 (2036)
Borders, Monroeville, PA	1996	37,004	Nov 8, 2016 (2036)
Borders, Norman, OK	1996	24,641	Sep 20, 2016 (2036)
Borders, Omaha, NE	1995	30,000	Nov 3, 2015 (2035)
Borders, Santa Barbara, CA	1995	38,015	Nov 17, 2015 (2035)
Borders, Wichita, KS	1995	25,000	Nov 10, 2015 (2035)
Borders, Lawrence, KS	1997	20,000	Oct 16, 2022 (2042)

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Borders, Tulsa, OK	1998	25,000	Sep 30, 2018 (2038)
Borders, Oklahoma City, OK	2002	24,641	Nov 17, 2017 (2037)
Borders, Omaha, NE	2002	25,000	Nov 17, 2017 (2037)
Borders, Indianapolis, IN	2002	15,844	Nov 17, 2017 (2037)

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Tenant/Location	Year Completed/ Expanded	Total GLA	Lease Expiration(2) (Option expiration)
Borders, Columbia, MD	1999	28,000	Oct 16, 2022 (2042)
Borders, Germantown, MD	2000	25,000	Oct 16, 2022 (2042)
Borders Headquarters, Ann Arbor, MI	1996/1998	458,729	Jan 29, 2023 (2043)
Borders, Tulsa, OK	1996	25,000	Sep 30, 2018 (2038)
Borders, Boynton Beach, FL	1996	25,000	July 20, 2024 (2044)
Borders, Ann Arbor, MI	1996	110,000	July 20, 2024 (2044)
Circuit City, Boynton Beach, FL	1996	32,459	Apr 30, 2009
Citizens Bank, Flint, MI	2003	4,426	Apr 15, 2023
Eckerd Drugs, Webster, NY	2004	13,813	Feb 24, 2024 (2044)
Eckerd Drugs, Albion, NY	2004	13,813	Oct 12, 2024 (2044)
Fajita Factory, Lansing, MI	2004	Note	(3) Aug 31, 2014 (2032)
Lake Lansing RA Associates, LLC, East Lansing, MI	2004	Note	(4) Dec 31, 2028 (2078)
Kmart, Grayling, MI	1984	52,320	Sep 30, 2009 (2059)
Kmart, Oscoda, MI	1984/1990	90,470	Sep 30, 2009 (2059)
Meijer, Plainfield, IN	2007	Note	(5) Nov 5, 2027 (2047)
Rite Aid, Canton Twp, MI	2003	11,180	Oct 31, 2019 (2049)
Rite Aid, Roseville, MI	2005	11,060	June 30, 2025 (2050)
Rite Aid, Mt Pleasant, MI	2005	11,095	Nov 30, 2025 (2065)
Rite Aid, N Cape May, NJ	2005	10,118	Nov 30, 2025 (2065)
Rite Aid, Summit Twp, MI	2006	11,060	Oct 31, 2019 (2039)
Sam's Club, Roseville, MI	2002	Note	(6) Aug 4, 2022 (2082)
Walgreen, Waterford, MI	1997	13,905	Feb 28, 2018 (2058)
Walgreen, Chesterfield, MI	1998	13,686	July 31, 2018 (2058)
Walgreen, Pontiac, MI	1998	13,905	Oct 31, 2018 (2058)
Walgreen, Grand Blanc, MI	1998	13,905	Feb 28, 2019 (2059)
Walgreen, Rochester, MI	1998	13,905	June 30, 2019 (2059)
Walgreen, Ypsilanti, MI	1999	15,120	Dec 31, 2019 (2059)