AGREE REALTY CORP
Form 10-Q
October 23, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Mark One

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

For the quarterly period ended September 30, 2017, or

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

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.)

70 E. Long Lake Road, Bloomfield Hills, Michigan 48304

(Address of Principal Executive Offices)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

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

Yes x No ¨

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

Large Accelerated Filer x	Accelerated Filer ¨	Non-accelerated Filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨	Emerging growth company ¨

If an emerging growth company, indicated by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

Yes ¨ No x

As of October 20, 2017, the Registrant had 29,215,835 shares of common stock, $0.0001 par value, outstanding.

AGREE REALTY CORPORATION

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AGREE REALTY CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per-share data)

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

	September 30, 2017 (Unaudited)	December 31, 2016
ASSETS		
Real Estate Investments		
Land	$ 371,047	$ 309,687
Buildings	820,138	703,506
Less accumulated depreciation	(80,356)	(69,696)
	1,110,829	943,497
Property under development	10,197	6,764
Net Real Estate Investments	1,121,026	950,261
Real Estate Held For Sale, net	9,003	-
Cash and Cash Equivalents	25,510	33,395
Cash Held in Escrows	1,779	-
Accounts Receivable - Tenants, net of allowance of $142 and $50 for possible losses at September 30, 2017 and December 31, 2016, respectively	15,634	11,535
Unamortized Deferred Expenses		
Credit facility finance costs, net of accumulated amortization of $332 and $1,262 at September 30, 2017 and December 31, 2016, respectively	1,275	1,552
Leasing costs, net of accumulated amortization of $772 and $677 at September 30, 2017 and December 31, 2016, respectively	1,601	1,227
Lease intangibles, net of accumulated amortization of $36,875 and $25,666 at September 30, 2017 and December 31, 2016, respectively	184,920	139,871
Interest Rate Swaps	1,232	1,409

Other Assets	4,993	2,722
Total Assets	$ 1,366,973	$ 1,141,972

See accompanying notes to consolidated financial statements.

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AGREE REALTY CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per-share data)

	September 30, 2017 (Unaudited)	December 31, 2016
LIABILITIES		
Mortgage Notes Payable, net	$ 67,458	$ 69,067
Unsecured Term Loans, net	158,305	158,679
Senior Unsecured Notes, net	259,112	159,176
Unsecured Revolving Credit Facility	-	14,000
Dividends and Distributions Payable	14,930	13,124
Deferred Revenue	1,452	1,823
Accrued Interest Payable	2,759	2,210
Accounts Payable and Accrued Expenses		
Capital expenditures	145	677
Operating	7,381	4,866
Lease intangibles, net of accumulated amortization of $10,246 and $7,079 at September 30, 2017 and December 31, 2016, respectively	30,529	30,047
Interest Rate Swaps	1,284	1,994
Deferred Income Taxes	705	705
Tenant Deposits	96	94
Total Liabilities	544,156	456,462
EQUITY		
Common stock, $.0001 par value, 45,000,000 shares authorized, 29,215,835 and 26,164,977 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively	3	3
Preferred Stock, $.0001 par value per share, 4,000,000 shares authorized		

Series A junior participating preferred stock, $.0001 par value, 200,000 authorized, no shares issued and outstanding	-	-
Additional paid-in-capital	849,442	712,069
Dividends in excess of net income	(29,136)	(28,558)
Accumulated other comprehensive loss	(10)	(536)
Total Equity - Agree Realty Corporation	820,299	682,978
Non-controlling interest	2,518	2,532
Total Equity	822,817	685,510
Total Liabilities and Equity	$ 1,366,973	$ 1,141,972

See accompanying notes to consolidated financial statements.

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AGREE REALTY CORPORATION

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(In thousands, except share and per-share data)

(Unaudited)

	Three Months Ended		**Nine Months Ended**	
	September 30, 2017	**September 30, 2016**	**September 30, 2017**	**September 30, 2016**
Revenues				
Minimum rents	$27,325	$ 22,279	$76,500	$ 60,682
Percentage rents	-	7	212	197
Operating cost reimbursement	2,791	1,845	8,016	5,368
Other income	271	30	299	(18)
Total Revenues	30,387	24,161	85,027	66,229
Operating Expenses				
Real estate taxes	2,149	1,473	5,988	4,035
Property operating expenses	931	169	2,641	1,669
Land lease payments	163	163	490	490
General and administrative	2,491	2,020	7,665	6,107
Depreciation and amortization	8,228	6,151	22,956	16,901
Total Operating Expenses	13,962	9,976	39,740	29,202
Income from Operations	16,425	14,185	45,287	37,027
Other (Expense) Income				
Interest expense, net	(4,666)	(4,091)	(13,213)	(11,236)
Gain (Loss) on sale of assets, net	524	4,415	10,045	7,133
Loss on debt extinguishment	-	(33)	-	(33)
Net Income	12,283	14,476	42,119	32,891
Less Net Income Attributable to Non-Controlling Interest	118	213	501	506
			.	
Net Income Attributable to Agree Realty Corporation	$12,165	$ 14,263	$41,618	$ 32,385
Net Income Per Share Attributable to Agree Realty Corporation				
Basic	$0.42	$ 0.61	$1.53	$ 1.47
Diluted	$0.42	$ 0.61	$1.52	$ 1.46

Other Comprehensive Income				
Net income	$12,283	$ 14,476	$42,119	$ 32,891
Other Comprehensive Income (Loss) - Gain (Loss) on Interest Rate Swaps	203	1,378	533	(3,236)
Total Comprehensive Income	12,486	15,854	42,652	29,655
Comprehensive Income Attributable to Non-Controlling Interest	(149)	(229)	(509)	(456)
Comprehensive Income Attributable to Agree Realty Corporation	$12,337	$ 15,625	$42,143	$ 29,199
Weighted Average Number of Common Shares Outstanding - Basic:	28,573,022	23,454,083	26,988,589	22,034,389
Weighted Average Number of Common Shares Outstanding - Diluted:	28,656,684	23,563,331	27,069,352	22,127,329

See accompanying notes to consolidated financial statements.

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AGREE REALTY CORPORATION

CONSOLIDATED STATEMENT OF EQUITY

(In thousands, except share and per-share data)

(Unaudited)

	Common Stock		Additional	Dividends in excess of net	Accumulated Other Comprehensive	Non-Controlling	Total
	Shares	Amount	Paid-In Capital	**income**	Income (Loss)	Interest	Equity
Balance, December 31, 2016	26,164,977	$ 3	$ 712,069	$ (28,558)	$ (536)	$ 2,532	$ 685,510
Issuance of common stock, net of issuance costs	3,009,838	-	136,733	-	-	-	136,733
Repurchase of common shares	(23,857)	-	(1,108)	-	-	-	(1,108)
Issuance of restricted stock under the Omnibus Incentive Plan	76,099	-	-	-	-	-	-
Forfeiture of restricted stock	(11,222)	-	-	-	-	-	-
Vesting of restricted stock	-	-	1,748	-	-	-	1,748
Dividends and distributions declared for the period	-	-	-	(42,196)	-	(522)	(42,718)
Other comprehensive income (loss) - change in fair value of interest rate swaps	-	-	-	-	526	7	533
Net income	-	-	-	41,618	-	501	42,119
Balance, September 30, 2017	29,215,835	$ 3	$ 849,442	$ (29,136)	$ (10)	$ 2,518	$ 822,817

See accompanying notes to consolidated financial statements.

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AGREE REALTY CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30, 2017	**September 30, 2016**
Cash Flows from Operating Activities		
Net income	$42,119	$ 32,891
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	14,366	10,958
Amortization	8,590	5,943
Amortization from financing and credit facility costs	730	523
Stock-based compensation	1,748	1,726
(Gain) loss on extinguishment of debt	-	33
(Gain) loss on sale of assets	(10,045)	(7,133)
(Increase) decrease in accounts receivable	(4,192)	(3,204)
(Increase) decrease in other assets	(148)	167
Increase (decrease) in accounts payable	1,837	2,798
Increase (decrease) in deferred revenue	(371)	(541)
Increase (decrease) in accrued interest	549	1,608
Increase (decrease) in tenant deposits	2	65
Net Cash Provided by Operating Activities	55,185	45,834
Cash Flows from Investing Activities		
Acquisition of real estate investments and other assets	(241,132)	(235,855)
Development of real estate investments and other assets (including capitalized interest of $297 in 2017 and $28 in 2016)	(27,240)	(20,262)
Payment of leasing costs	(544)	(648)
Cash held in escrows on sale of assets	(1,779)	(12,292)
(Increase) decrease in Net proceeds from sale of assets	29,414	22,098
Net Cash Used In Investing Activities	(241,281)	(246,959)
Cash Flows from Financing Activities		
Proceeds from common stock offerings, net	136,733	124,099
Repurchase of common shares	(1,108)	(712)
Unsecured revolving credit facility borrowings	184,000	227,000
Unsecured revolving credit facility repayments	(198,000)	(198,000)
Payments of mortgage notes payable	(1,794)	(31,059)
Unsecured term loan proceeds	-	60,283
Payments of unsecured term loans	(549)	-

Senior unsecured notes proceeds	100,000	60,000
Dividends paid	(40,392)	(30,593)
Distributions to Non-Controlling Interest	(520)	(490)
Payments for financing costs	(159)	(624)
Net Cash Provided by Financing Activities	178,211	209,904
Net Increase (Decrease) in Cash and Cash Equivalents	(7,885)	8,779
Cash and Cash Equivalents, beginning of period	33,395	2,712
Cash and Cash Equivalents, end of period	$25,510	$ 11,491
Supplemental Disclosure of Cash Flow Information		
Cash paid for interest (net of amounts capitalized)	$12,658	$ 9,159
Cash paid (refunded) for income tax	$3	$ 8
Supplemental Disclosure of Non-Cash Investing and Financing Activities		
Shares issued under equity incentive plans (in dollars)	$3,022	$ 3,059
Dividends and limited partners' distributions declared and unpaid	$14,930	$ 11,631

See accompanying notes to consolidated financial statements.

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AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

(Unaudited)

Note 1 – Organization

Agree Realty Corporation (the “Company”), a Maryland corporation, is a fully integrated real estate investment trust (“REIT”) primarily focused on the ownership, acquisition, development and management of retail properties net leased to industry leading tenants. The Company was founded in 1971 by its current Executive Chairman, Richard Agree, and our common stock was listed on the New York Stock Exchange (“NYSE”) in 1994.

Our assets are held by, and all of our operations are conducted through, directly or indirectly, Agree Limited Partnership (the “Operating Partnership”), of which Agree Realty Corporation is the sole general partner and in which it held a 98.8% interest as of September 30, 2017. Under the partnership agreement of the Operating Partnership, Agree Realty Corporation, as the sole general partner, has exclusive responsibility and discretion in the management and control of the Operating Partnership.

The terms “Agree Realty,” the "Company," “Management,” "we,” “our” or "us" refer to Agree Realty Corporation and all of its consolidated subsidiaries, including the Operating Partnership.

Note 2 – Summary of Significant Accounting Policies

Basis of Accounting and Principles of Consolidation

The accompanying unaudited consolidated financial statements for the nine months ended September 30, 2017 have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) 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 GAAP for audited financial statements. The unaudited consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the interim period presented. Operating results for the nine months ended September 30, 2017 may not be indicative of the results that may be expected for the year ending December 31, 2017. Amounts as of December 31, 2016 included in the consolidated financial statements have been derived from the audited consolidated financial statements as of that date. The unaudited consolidated financial statements, included herein, should be read in conjunction with the audited consolidated financial statements and notes thereto, as well as Management's Discussion and Analysis of Financial Condition and Results of Operations, in our Form 10-K for the year ended

December 31, 2016.

The unaudited consolidated financial statements include the accounts of the Company, the Operating Partnership and its wholly-owned subsidiaries. All material intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of (1) assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements, and (2) revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassification

Certain reclassifications of prior period amounts have been made in the consolidated financial statements and footnotes in order to conform to the current presentation. Prepaid rents are presented on the Balance Sheet as Deferred Revenue; in previously filed reports prepaid rents were presented in Accounts Payable - Operating. The classification of below-market lease intangibles are presented net of accumulated amortization as a Liability; in previously filed reports below-market lease intangibles were presented in Unamortized Deferred Expenses: Lease Intangibles, net with in-place and above-market lease intangibles. As of September 30, 2017, all fully amortized deferred financing costs attributable to the credit facility were written off. Cash held in escrows are presented on the Statement of Cash Flows in investing activities; in previously filed reports cash held in escrows were presented in operating activities.

Segment Reporting

The Company is primarily in the business of acquiring, developing and managing retail real estate which is considered to be one reporting segment. The Company has no other reporting segments.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

(Unaudited)

Real Estate Investments

The Company records the acquisition of real estate at cost, including acquisition and closing costs. For properties developed by the Company, all direct and indirect costs related to planning, development and construction, including interest, real estate taxes and other miscellaneous costs incurred during the construction period, are capitalized for financial reporting purposes and recorded as property under development until construction has been completed. Properties classified as “held for sale” are recorded at the lower of their carrying value or their fair value, less anticipated selling costs.

Accounting for Acquisitions of Real Estate

The acquisition of property for investment purposes is typically accounted for as an asset acquisition. The Company allocates the purchase price to land, buildings and identified intangible assets and liabilities, based in each case on their relative estimated fair values and without giving rise to goodwill. Intangible assets and liabilities represent the value of in-place leases and above- or below-market leases. In making estimates of fair values, the Company may use a number of sources, including data provided by independent third parties, as well as information obtained by the Company as a result of its due diligence, including expected future cash flows of the property and various characteristics of the markets where the property is located.

In allocating the fair value of the identified intangible assets and liabilities of an acquired property, in-place lease intangibles are valued based on the Company’s estimates of costs related to tenant acquisition and the carrying costs that would be incurred during the time it would take to locate a tenant if the property were vacant, considering current market conditions and costs to execute similar leases at the time of the acquisition. Above- and below-market lease intangibles are recorded based on the present value of the difference between the contractual amounts to be paid pursuant to the leases at the time of acquisition and the Company’s estimate of current market lease rates for the property. The capitalized above- and below-market lease intangibles are amortized over the non-cancelable term of the lease unless the Company believes it is reasonably certain that the tenant will renew the lease for an option term whereby the Company amortizes the value attributable to the renewal over the renewal period.

The fair value of identified intangible assets and liabilities acquired is amortized to depreciation and amortization over the remaining term of the related leases.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of cash and money market accounts. The account balances periodically exceed the Federal Deposit Insurance Corporation ("FDIC") insurance coverage, and as a result, there is a concentration of credit risk related to amounts on deposit in excess of FDIC insurance coverage. We had $25.8 million and $32.4 million in cash as of September 30, 2017 and December 31, 2016, respectively, in excess of the FDIC insured limit.

Accounts Receivable – Tenants

The Company reviews its rent receivables for collectability on a regular basis, taking into consideration changes in factors such as the tenant's payment history, the financial condition of the tenant, business conditions in the industry in which the tenant operates and economic conditions in the area where the property is located. In the event that the collectability of a receivable with respect to any tenant is in doubt, a provision for uncollectible amounts will be established or a direct write-off of the specific rent receivable will be made. For accrued rental revenues related to the straight-line method of reporting rental revenue, the Company performs a periodic review of receivable balances to assess the risk of uncollectible amounts and establish appropriate provisions.

The Company's leases provide for reimbursement from tenants for common area maintenance ("CAM"), insurance, real estate taxes and other operating expenses ("Operating Cost Reimbursement Revenue"). A portion of our Operating Cost Reimbursement Revenue is estimated each period and is recognized as revenue in the period the recoverable costs are incurred and accrued. Receivables from Operating Cost Reimbursement Revenue are included in our Accounts Receivable - Tenants line item in our consolidated balance sheets. The balance of unbilled Operating Cost Reimbursement Receivable at September 30, 2017 and December 31, 2016 was $1.9 million and $1.1 million, respectively.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

(Unaudited)

In addition, many of the Company’s leases contain rent escalations for which we recognize revenue on a straight-line basis over the non-cancelable lease term. This method results in rental revenue in the early years of a lease being higher than actual cash received, creating a straight-line rent receivable asset which is included in the Accounts Receivable - Tenants line item in our consolidated balance sheet. The balance of straight-line rent receivables at September 30, 2017 and December 31, 2016 was $12.0 million and $9.6 million, respectively. To the extent any of the tenants under these leases become unable to pay their contractual cash rents, the Company may be required to write down the straight-line rent receivable from those tenants, which would reduce operating income.

Sales Tax

The Company collects various taxes from tenants and remits these amounts, on a net basis, to the applicable taxing authorities.

Unamortized Deferred Expenses

Deferred expenses include debt financing costs related to the line of credit, leasing costs and lease intangibles, and are amortized as follows: (i) debt financing costs related to the line of credit on a straight-line basis to interest expense over the term of the related loan, which approximates the effective interest method; (ii) leasing costs on a straight-line basis to depreciation and amortization over the term of the related lease entered into; and (iii) lease intangibles on a straight-line basis to depreciation and amortization over the remaining term of the related lease acquired.

The following schedule summarizes the Company’s amortization of deferred expenses for the three and nine months ended September 30, 2017 and 2016 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Credit Facility Financing Costs	$ 102	$ 57	$ 304	$ 162

Leasing Costs	40	38	120	83
Lease Intangibles (Asset)	3,802	2,973	11,209	8,030
Lease Intangibles (Liability)	(1,037)	(825)	(3,167)	(2,170)
Total	$ 2,907	$ 2,243	$ 8,466	$ 6,105

The following schedule represents estimated future amortization of deferred expenses as of September 30, 2017 (in thousands):

Year Ending December 31,	2017 (remaining)	2018	2019	2020	2021	Thereafter	Total
Credit Facility Financing Costs	$ 101	$ 394	$ 379	$ 380	$ 21	$ -	$ 1,275
Leasing Costs	41	181	218	204	188	769	1,601
Lease Intangibles (Asset)	4,538	18,214	17,542	17,073	16,384	111,169	184,920
Lease Intangibles (Liability)	(1,105)	(4,348)	(4,274)	(4,173)	(3,880)	(12,749)	(30,529)
Total	$ 3,575	$ 14,441	$ 13,865	$ 13,484	$ 12,713	$ 99,189	$ 157,267

Earnings per Share

Earnings per share have been computed by dividing the net income after allocation by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average common shares and potentially dilutive common shares outstanding in accordance with the treasury stock method.

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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AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2017	**September 30, 2016**	**September 30, 2017**	**September 30, 2016**
Weighted average number of common shares outstanding	28,792,158	23,674,133	27,207,725	22,254,439
Less: Unvested restricted stock	(219,136)	(220,050)	(219,136)	(220,050)
Weighted average number of common shares outstanding used in basic earnings per share	28,573,022	23,454,083	26,988,589	22,034,389
Weighted average number of common shares outstanding used in basic earnings per share	28,573,022	23,454,083	26,988,589	22,034,389
Effect of dilutive securities: restricted stock	83,662	109,248	80,763	92,940
Weighted average number of common shares outstanding used in diluted earnings per share	28,656,684	23,563,331	27,069,352	22,127,329

Income Taxes (not presented in thousands)

The Company has elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"). As a REIT, the Company generally will not be subject to federal income tax provided it continues to satisfy certain tests concerning the Company's sources of income, the nature of its assets, the amounts distributed to its stockholders, and the ownership of Company stock. Management believes the Company has qualified and will continue to qualify as a REIT. Notwithstanding the Company's qualification for taxation as a REIT, the Company is subject to certain state and local taxes on its income and real estate.

The Company has established taxable REIT subsidiaries ("TRS") pursuant to the provisions of the Internal Revenue Code. The Company's TRS entities are able to engage in activities resulting in income that would be non-qualifying income for a REIT. As a result, certain activities of the Company which occur within its TRS entities are subject to federal and state income taxes. As of September 30, 2017 and December 31, 2016, the Company had accrued a deferred income tax amount of $705,000. In addition, the Company recognized income tax expense of $2,060 and $0 for the three months ended September 30, 2017 and 2016, respectively, and $2,894 and $7,747 for the nine months ended September 30, 2017 and 2016, respectively.

Fair Values of Financial Instruments

The Company’s estimates of fair value of financial and non-financial assets and liabilities are based on the framework established in the fair value accounting guidance. The framework specifies a hierarchy of valuation inputs which was established to increase consistency, clarity and comparability in fair value measurements and related disclosures. The guidance describes a fair value hierarchy based upon three levels of inputs that may be used to measure fair value, two of which are considered observable and one that is considered unobservable. The following describes the three levels:

Level 1 –	Valuation is based upon quoted prices in active markets for identical assets or liabilities.
Level 2 –	Valuation is based upon inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3 –	Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include option pricing models, discounted cash flow models and similar techniques.

Recent Accounting Pronouncements

In August 2017, the Financial Accounting Standards Board (”FASB”) issued ASU No. 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities” (“ASU 2017-12”). The objective of ASU 2017-12 is to expand hedge accounting for both financial (interest rate) and commodity risks, and create more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes. ASU 2017-12 will be effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods in the year of adoption. Early adoption is permitted for any interim or annual period. The Company is in the process of determining the impact that the implementation of ASU 2017-12 will have on the Company’s financial statements.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

(Unaudited)

In May 2017, the FASB issued ASU No. 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting” (“ASU 2017-09”). The objective of ASU 2017-09 is to provide guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. ASU 2017-09 will be effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods in the year of adoption. Early adoption is permitted for any interim or annual period. The Company is in the process of determining the impact that the implementation of ASU 2017-09 will have on the Company’s financial statements.

In January 2017, the FASB issued ASU No. 2017-01, “Business Combinations: Clarifying the Definition of a Business” (“ASU 2017-01”). The objective of ASU 2017-01 is to clarify the definition of a business by adding guidance on how entities should evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. ASU 2017-01 will be effective for public business entities for fiscal years beginning after December 15, 2017, including interim periods in the year of adoption. Early adoption is permitted for any interim or annual period. The Company has early adopted and the guidance has no material impact on the financial statements.

In February 2016, the FASB issued ASU No. 2016-02 “Leases” (“ASU 2016-02”). The new standard creates Topic 842, Leases, in FASB *Accounting Standards Codification* (FASB ASC) and supersedes FASB ASC 840, *Leases.* ASU 2016-02 requires a lessee to recognize the assets and liabilities that arise from leases (operating and finance). However, for leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election not to recognize lease assets and lease liabilities. The main difference between the existing guidance on accounting for leases and the new standard is that operating leases will now be recorded in the statement of financial position as assets and liabilities. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases and operating leases. ASU 2016-02 is expected to impact the Company’s consolidated financial statements as the Company has certain operating land lease arrangements for which it is the lessee. GAAP requires only capital (finance) leases to be recognized in the statement of financial position, and amounts related to operating leases largely are reflected in the financial statements as rent expense on the income statement and in disclosures to the financial statements. ASU 2016-02 is effective for annual reporting periods (including interim periods within those periods) beginning after December 15, 2018. Early adoption is permitted. The Company has engaged a professional services firm to assist in the implementation of ASU 2016-02. The Company anticipates that its retail leases where it is the lessor will continue to be accounted for as operating leases under the new standard. Therefore, the Company does not currently anticipate significant changes in the accounting for its lease revenues. The Company is also the lessee under various land lease arrangements and it will be required to recognize right of use assets and related lease liabilities on its consolidated balance sheets upon adoption. The Company will continue to evaluate the impact of adopting the new leases standard on its consolidated statements of income and comprehensive income and consolidated balance sheets.

In May 2014, with subsequent updates issued in August 2015 and March, April and May 2016, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"). ASU 2014-09 was developed to enable financial statement users to better understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The update's core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Companies are to use a five-step contract review model to ensure revenue is recognized, measured and disclosed in accordance with this principle. ASU 2014-09, as updated, is effective for fiscal years and interim periods beginning after December 15, 2017. The Company has engaged a professional services firm to assist in the implementation of ASU 2014-09. The Company is continuing to evaluate the standard; however, we do not expect its adoption to have a significant impact on the consolidated financial statements, as approximately 90% of total revenues consist of rental income from leasing arrangements, which is specifically excluded from the standard. In addition, given the nature of its disposition transactions, there should be no changes in accounting under the new standard.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

(Unaudited)

Note 3 – Real Estate Investments

Real Estate Portfolio

As of September 30, 2017, the Company owned 425 properties, with a total gross leasable area of 8.3 million square feet. Net Real Estate Investments totaled $1.1 billion as of September 30, 2017. As of December 31, 2016, the Company owned 366 properties, with a total gross leasable area of 7.0 million square feet. Net Real Estate Investments totaled $950.3 million as of December 31, 2016.

Investments

During the three months ended September 30, 2017, the Company acquired 14 retail net lease assets for approximately $55.1 million, which includes acquisition and closing costs. These properties are located in 12 states and are leased to 12 diverse tenants operating in 9 retail sectors for a weighted average lease term of approximately 11.2 years.

During the nine months ended September 30, 2017, the Company acquired 61 retail net lease assets for approximately $239.5 million, which includes acquisition and closing costs. These properties are located in 25 states and are leased to 45 diverse tenants operating in 21 retail sectors for a weighted average lease term of approximately 11.9 years.

The aggregate acquisitions for the nine months ended September 30, 2017 were allocated $58.7 million to land, $123.4 million to buildings and improvements, and $57.4 million to lease intangibles and other assets. The acquisitions were all cash purchases and there were no contingent considerations associated with these acquisitions.

None of the Company's acquisitions during the first nine months of 2017 caused any new or existing tenant to comprise 10% or more of its total assets or generate 10% or more of its total annualized base rent at September 30, 2017.

Developments

During the third quarter of 2017, construction continued or commenced on five development and Partner Capital Solutions (“PCS”) projects with anticipated total project costs of approximately $35.9 million. The projects consist of the Company’s first PCS project with Art Van Furniture in Canton, Michigan; two development projects with Mister Car Wash in Urbandale, Iowa and Bernalillo, New Mexico; one Burger King development in North Ridgeville, Ohio; and the Company’s third project with Camping World in Grand Rapids, Michigan.

During the nine months ended September 30, 2017, the Company had nine development or PCS projects completed or under construction. Anticipated total costs for those projects are approximately $57.3 million and include the following completed or commenced projects:

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

(Unaudited)

Tenant	Location	Lease Structure	Lease Term	Actual or Anticipated Rent Commencement	Status
Camping World	Tyler, TX	Build-to-Suit	20 Years	Q1 2017	Completed
Burger King(1)	Heber, UT	Build-to-Suit	20 Years	Q1 2017	Completed
Camping World	Georgetown, KY	Build-to-Suit	20 Years	Q2 2017	Completed
Orchard Supply	Boynton Beach, FL	Build-to-Suit	15 Years	Q3 2017	Completed
Mister Car Wash	Urbandale, IA	Build-to-Suit	20 years	Q4 2017	Under Construction
Mister Car Wash	Bernalillo, NM	Build-to-Suit	20 years	Q4 2017	Under Construction
Art Van Furniture	Canton, MI	Build-to-Suit	20 years	Q1 2018	Under Construction
Burger King(2)	North Ridgeville, OH	Build-to-Suit	20 years	Q1 2018	Under Construction
Camping World	Grand Rapids, MI	Build-to-Suit	20 years	Q2 2018	Under Construction

Notes:

(1) Franchise restaurant operated by Meridian Restaurants Unlimited, L.C.

(2) Franchise restaurant operated by TOMS King, LLC.

Dispositions

During the three months ended September 30, 2017, the Company sold real estate properties for net proceeds of $7.5 million and a recorded net gain of $0.5 million (net of any expected losses on real estate held for sale).

During the nine months ended September 30, 2017, the Company sold real estate properties for net proceeds of $29.4 million and a recorded net gain of $10.0 million (net of any expected losses on real estate held for sale).

Note 4 – Debt

We account for debt issuance costs under ASU 2015-03 which requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the gross carrying amount of that debt liability, consistent with debt discounts. Unamortized debt issuance costs of approximately $2.8 million and $3.1 million are included as an offset to the respective debt balances as of September 30, 2017 and December 31, 2016.

As of September 30, 2017, we had total gross indebtedness of $487.7 million, including (i) $68.2 million of mortgage notes payable; (ii) $159.5 million of unsecured term loans; (iii) $260.0 million of senior unsecured notes; and (iv) $0 borrowings under our Credit Facility.

Mortgage Notes Payable

As of September 30, 2017, the Company had total gross mortgage indebtedness of $68.2 million which was collateralized by related real estate with an aggregate net book value of $89.1 million. Including mortgages that have been swapped to a fixed interest rate, the weighted average interest rate on the Company’s mortgage notes payable was 3.90%.

AGREE REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2017

(Unaudited)

Mortgages payable consisted of the following:

	September 30, 2017	December 31, 2016
(not presented in thousands)	**(in thousands)**	
Note payable in monthly installments of interest only at LIBOR plus 160 basis points, swapped to a fixed rate of 2.49% with a balloon payment due April 4, 2018; collateralized by related real estate and tenants' leases	$ 25,000	&nbs