SAUL CENTERS INC
Form 10-Q
May 05, 2010
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United States

Securities and Exchange Commission

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the

Securities Exchange Act of 1934

For The Quarterly Period Ended March 31, 2010

Commission File Number 1-12254

SAUL CENTERS, INC.

(Exact name of registrant as specified in its charter)

Maryland	**52-1833074**
State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

7501 Wisconsin Avenue, Bethesda, Maryland 20814

(Address of principal executive office) (Zip Code)

Registrant s telephone number, including area code (301) 986-6200

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 requirement 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ¨ NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer, large accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	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 x

Number of shares of common stock, par value $0.01 per share outstanding as of May 5, 2010: 18,234,000.

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SAUL CENTERS, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments necessary for the fair presentation of the financial position and results of operations of Saul Centers, Inc. for the interim periods have been included. All such adjustments are of a normal recurring nature. These consolidated financial statements and the accompanying notes should be read in conjunction with the audited consolidated financial statements of Saul Centers, Inc. for the year ended December 31, 2009, which are included in its Annual Report on Form 10-K. The results of operations for interim periods are not necessarily indicative of results to be expected for the year.

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Saul Centers, Inc.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)	**March 31, 2010** *(Unaudited)*	**December 31, 2009**
Assets		
Real estate investments		
Land	$ 223,286	$ 223,193
Buildings and equipment	742,471	740,442
Construction in progress	165,400	147,589
	1,131,157	1,111,224
Accumulated depreciation	(282,271)	(276,310)
	848,886	834,914
Cash and cash equivalents	19,432	20,607
Accounts receivable and accrued income, net	38,599	37,503
Deferred leasing costs, net	15,191	15,609
Prepaid expenses, net	2,532	3,096
Deferred debt costs, net	7,291	7,537
Other assets	8,454	6,308
Total assets	$ 940,385	$ 925,574
Liabilities		
Mortgage notes payable	$ 572,236	$ 576,069
Construction loans payable	71,760	60,737
Dividends and distributions payable	12,260	12,220
Accounts payable, accrued expenses and other liabilities	26,923	23,395
Deferred income	26,952	27,090
Total liabilities	710,131	699,511
Stockholders equity		
Preferred stock, 1,000,000 shares authorized:		
Series A Cumulative Redeemable, 40,000 shares issued and outstanding	100,000	100,000
Series B Cumulative Redeemable, 31,731 shares issued and outstanding	79,328	79,328
Common stock, $0.01 par value, 30,000,000 shares authorized, 18,125,152 and 18,012,416 shares issued and outstanding, respectively	181	180
Additional paid-in capital	173,239	169,363
Accumulated deficit	(123,925)	(124,167)
Total Saul Centers, Inc. stockholders equity	228,823	224,704
Noncontrolling interest	1,431	1,359
Total stockholders equity	230,254	226,063
Total liabilities and stockholders equity	$ 940,385	$ 925,574

The accompanying notes are an integral part of these statements

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Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(Dollars in thousands, except per share amounts)	For The Three Months Ended March 31, 2010	2009
Revenue		
Base rent	$ 31,695	$ 30,665
Expense recoveries	8,727	7,580
Percentage rent	358	233
Other	2,868	1,211
Total revenue	43,648	39,689
Operating expenses		
Property operating expenses	7,679	5,370
Provision for credit losses	197	327
Real estate taxes	4,685	4,416
Interest expense and amortization of deferred debt costs	8,591	8,196
Depreciation and amortization of deferred leasing costs	7,073	7,041
General and administrative	2,849	2,789
Total operating expenses	31,074	28,139
Net income	12,574	11,550
Noncontrolling interest		
Income attributable to the noncontrolling interest	(2,021)	(1,809)
Net income attributable to Saul Centers, Inc.	10,553	9,741
Preferred dividends	(3,785)	(3,785)
Net income available to common stockholders	$ 6,768	$ 5,956
Per share net income available to common stockholders		
Basic and Diluted	$ 0.37	$ 0.33
Dividends declared per common share outstanding	$ 0.36	$ 0.39

The accompanying notes are an integral part of these statements

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Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(Unaudited)

(Dollars in thousands, except per share amounts)	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total Saul Centers, Inc.	Noncontrolling Interest	Total
Balance, December 31, 2009	$ 179,328	$ 180	$ 169,363	$ (124,167)	$ 224,704	$ 1,359	$ 226,063
Issuance of 112,736 shares of common stock:							
100,565 shares pursuant to dividend reinvestment plan		1	3,476		3,477		3,477
12,171 shares due to exercise of stock options and issuance of directors deferred stock			400		400		400
Net income				10,553	10,553	2,021	12,574
Distributions payable preferred stock:							
Series A, $50.00 per share				(2,000)	(2,000)		(2,000)
Series B, $56.25 per share				(1,785)	(1,785)		(1,785)
Distributions payable common stock ($0.36/share) and distributions payable partnership units ($0.36/unit)				(6,526)	(6,526)	(1,949)	(8,475)
Balance, March 31, 2010	$ 179,328	$ 181	$ 173,239	$ (123,925)	$ 228,823	$ 1,431	$ 230,254

The accompanying notes are an integral part of these statements

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Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)	For The Three Months Ended March 31, 2010	2009
Cash flows from operating activities:		
Net income	$ 12,574	$ 11,550
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of deferred leasing costs	7,073	7,041
Amortization of deferred debt costs	367	299
Non cash compensation costs of stock grants and options	139	165
Provision for credit losses	197	327
(Increase) decrease in accounts receivable and accrued income	(1,293)	2,749
Increase in deferred leasing costs	(607)	(892)
Increase in prepaid expenses	564	405
Increase in other assets	(2,146)	(4,118)
Increase in accounts payable, accrued expenses and other liabilities	2,238	3,230
Decrease in deferred income	(138)	(365)
Net cash provided by operating activities	18,968	20,391
Cash flows from investing activities:		
Additions to real estate investments	(1,497)	(1,630)
Additions to development and redevelopment activities	(17,233)	(15,827)
Net cash used in investing activities	(18,730)	(17,457)
Cash flows from financing activities:		
Repayments on mortgage notes payable	(3,833)	(4,422)
Proceeds from construction loans payable	11,023	6,364
Proceeds from revolving credit facility		15,000
Additions to deferred debt costs	(121)	
Proceeds from the issuance of common stock	3,738	243
Distributions to:		
Series A preferred stockholders	(2,000)	(2,000)
Series B preferred stockholders	(1,785)	(1,785)
Common stockholders	(6,485)	(6,967)
Noncontrolling interest	(1,950)	(2,112)
Net cash (used in) provided by financing activities	(1,413)	4,321
Net (decrease) increase in cash and cash equivalents	(1,175)	7,255
Cash and cash equivalents, beginning of period	20,607	13,006
Cash and cash equivalents, end of period	$ 19,432	$ 20,261

The accompanying notes are an integral part of these statements

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Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited)

1. Organization, Formation and Structure

Saul Centers, Inc. (Saul Centers) was incorporated under the Maryland General Corporation Law on June 10, 1993. Saul Centers operates as a real estate investment trust (a REIT) under the Internal Revenue Code of 1986, as amended (the Code). A REIT is required to annually distribute at least 90% of its REIT taxable income (excluding net capital gains) to its stockholders and meet certain organizational and other requirements. Saul Centers has made and intends to continue to make regular quarterly distributions to its stockholders. Saul Centers, together with its wholly owned subsidiaries and the limited partnerships of which Saul Centers or one of its subsidiaries is the sole general partner, are referred to collectively as the Company. B. Francis Saul II serves as Chairman of the Board of Directors and Chief Executive Officer of Saul Centers.

Saul Centers was formed to continue and expand the shopping center business previously owned and conducted by the B.F. Saul Real Estate Investment Trust, the B.F. Saul Company and certain other affiliated entities, each of which is currently controlled by B. Francis Saul II and his family members (collectively, The Saul Organization). On August 26, 1993, members of The Saul Organization transferred to Saul Holdings Limited Partnership, a newly formed Maryland limited partnership (the Operating Partnership), and two newly formed subsidiary limited partnerships (the Subsidiary Partnerships, and collectively with the Operating Partnership, the Partnerships), shopping center and office properties, and the management functions related to the transferred properties. Since its formation, the Company has developed and purchased additional properties.

The following table lists the properties acquired and/or developed by the Company since December 31, 2008. Both of the following properties are operating shopping centers.

Name of Property	Location	Date of Acquisition/ Development
Developments		
Northrock	Warrenton, VA	2008/9
Westview Village	Frederick, MD	2007/9

As of March 31, 2010, the Company s properties (the Current Portfolio Properties) consisted of 47 operating shopping center properties (the Shopping Centers), five predominantly office operating properties (the Office Properties) and four (non-operating) land or development properties.

In September 1997, the Company established Saul QRS, Inc., a wholly owned subsidiary of Saul Centers, to facilitate the placement of collateralized mortgage debt. Saul QRS, Inc. was created to succeed to the interest of Saul Centers as the sole general partner of Saul Subsidiary I Limited Partnership. The remaining limited partnership interests in Saul Subsidiary I Limited Partnership and Saul Subsidiary II Limited Partnership are held by the Operating Partnership as the sole limited partner. Through this structure, the Company owns 100% of the Current Portfolio Properties.

Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

2. Summary of Significant Accounting Policies

Nature of Operations

The Company, which conducts all of its activities through its subsidiaries, the Operating Partnership and Subsidiary Partnerships, engages in the ownership, operation, management, leasing, acquisition, renovation, expansion, development and financing of community and neighborhood shopping centers and office properties, primarily in the Washington, DC/Baltimore metropolitan area.

Because the properties are located primarily in the Washington, DC/Baltimore metropolitan area, the Company is subject to a concentration of credit risk related to these properties. A majority of the Shopping Centers are anchored by several major tenants. As of March 31, 2010, thirty-one of the Shopping Centers were anchored by a grocery store and offer primarily day-to-day necessities and services. Three retail tenants, Giant Food (4.5%), a tenant at eight Shopping Centers, Safeway (3.4%), a tenant at eight Shopping Centers and Chevy Chase Bank (2.6%), a tenant at twenty properties, and one office tenant, the United States Government (2.5%), a tenant at six properties, individually accounted for 2.5% or more of the Company s total revenue for the three months ended March 31, 2010.

Principles of Consolidation

The accompanying consolidated financial statements of the Company include the accounts of Saul Centers and its subsidiaries, including the Operating Partnership and Subsidiary Partnerships, which are majority owned by Saul Centers. All significant intercompany balances and transactions have been eliminated in consolidation.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with U.S. GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments necessary for the fair presentation of the financial position and results of operations of Saul Centers, Inc. for the interim periods have been included. All such adjustments are of a normal recurring nature. These consolidated financial statements and the accompanying notes should be read in conjunction with the audited consolidated financial statements of Saul Centers, Inc. for the year ended December 31, 2009, which are included in its Annual Report on Form 10-K. The results of operations for interim periods are not necessarily indicative of results to be expected for the year.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

Real Estate Investment Properties

The Company purchases real estate investment properties from time to time and allocates the purchase price to various components, such as land, buildings, and intangibles related to in-place leases and customer relationships, based on the fair value of each component. The fair value of buildings is determined as if the buildings were vacant upon acquisition and subsequently leased at market rental rates. As such, the determination of fair value considers the present value of all cash flows expected to be generated from the property including an initial lease up period. The Company determines the fair value of above and below market intangibles associated with in-place leases by assessing the net effective rent and remaining term of the lease relative to market terms for similar leases at acquisition. In the case of above and below market leases, the Company considers the remaining contractual lease period and renewal periods, taking into consideration the likelihood of the tenant exercising its renewal options. The fair value of a below market lease component is recorded as deferred income and amortized as additional lease revenue over the remaining contractual lease period and any renewal option periods included in the valuation analysis. The fair value of above market lease intangibles is recorded as a deferred asset and is amortized as a reduction of lease revenue over the remaining contractual lease term. The Company determines the fair value of at-market in-place leases considering the cost of acquiring similar leases, the foregone rents associated with the lease-up period and carrying costs associated with the lease-up period. Intangible assets associated with at-market in-place leases are amortized as additional expense over the remaining contractual lease term. To the extent customer relationship intangibles are present in an acquisition, the fair value of the intangibles is amortized over the life of the customer relationship. The Company has never recorded a customer relationship intangible asset.

If there is an event or change in circumstance that indicates an impairment in the value of a real estate investment property, the Company prepares an impairment analysis to assess that the carrying value of the real estate investment property does not exceed its estimated fair value. The Company considers both quantitative and qualitative factors including recurring operating losses, significant decreases in occupancy, and significant adverse changes in legal factors and business climate. If impairment indicators are present, the Company compares the projected cash flows of the property over its remaining useful life, on an undiscounted basis, to the carrying value of that property. The Company assesses its undiscounted projected cash flows based upon estimated capitalization rates, historic operating results and market conditions that may affect the property. If such carrying value is greater than the undiscounted projected cash flows, the Company would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its then estimated fair value. The value of any property is sensitive to the actual results of any of the aforementioned estimated factors, either individually or taken as a whole. Should the actual results differ from management s projections, the valuation could be negatively or positively affected. The Company did not recognize an impairment loss on any of its real estate during the three month periods ended March 31, 2010 and 2009.

Interest, real estate taxes, development-related salary costs and other carrying costs are capitalized on projects under development and construction. Once construction is substantially completed and the assets are placed in service, their rental income, real estate tax expense, property operating expenses (consisting of payroll, repairs and maintenance, utilities, insurance and other property related expenses) and depreciation are included in current operations. Property operating expenses are charged to operations as incurred. Interest expense capitalized

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Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

totaled approximately $1,828,000 and $1,359,000, for the three month periods ended March 31, 2010 and 2009, respectively. A project is considered substantially complete and available for occupancy upon completion of tenant improvements, but no later than one year from the cessation of major construction activity. Substantially completed portions of a project are accounted for as separate projects.

Depreciation is calculated using the straight-line method and estimated useful lives of 35 to 50 years for base buildings and up to 20 years for certain other improvements that extend the useful lives. In addition, the Company capitalizes leasehold improvements when certain criteria are met, including when we supervise construction and will own the improvements. Tenant improvements are amortized, over the shorter of the lives of the related leases or the useful life of the improvements, using the straight-line method. The depreciation component included in depreciation and amortization expense in the consolidated statements of operations totaled approximately $6,048,000 and $5,818,000, for the three month periods ended March 31, 2010 and 2009, respectively. Repair and maintenance expense, included in property operating expenses, for the three month periods ended March 31, 2010 and 2009, was approximately $4,819,000 and $2,552,000, respectively.

Deferred Leasing Costs

Deferred leasing costs consist of commissions paid to third-party leasing agents, internal direct costs such as employee compensation and payroll-related fringe benefits directly related to time spent performing leasing-related activities for successful leases and amounts attributed to in place leases associated with acquired properties. Leasing related activities include evaluating the prospective tenant s financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating lease terms, preparing lease documents and closing the transaction. The carrying amount of these costs is written-off to expense if the applicable lease is terminated prior to expiration of the initial lease term. Deferred leasing costs are amortized over the initial term of the lease or remaining initial term of acquired leases. Collectively, deferred leasing costs totaled $15,191,000 and $15,609,000, net of accumulated amortization of $15,077,000 and $14,889,000, as of March 31, 2010 and December 31, 2009, respectively. Amortization expense, included in depreciation and amortization in the consolidated statements of operations, totaled $1,025,000 and $1,223,000, for the three months ended March 31, 2010 and 2009, respectively.

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Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

Construction In Progress

Construction in progress includes preconstruction costs and development costs of active projects. Preconstruction costs associated with these projects include legal, zoning and permitting costs and other project carrying costs incurred prior to the commencement of construction. Development costs include direct construction costs and indirect costs incurred subsequent to the start of construction such as architectural, engineering, construction management and carrying costs consisting of interest, real estate taxes and insurance. Construction in progress balances as of March 31, 2010 and December 31, 2009 are as follows:

Construction in Progress

(Dollars in thousands)	March 31, 2010	December 31, 2009
Clarendon Center	$ 133,940	$ 115,810
Northrock	12,003	11,910
Westview Village	18,698	18,730
Other	759	1,139
Total	$ 165,400	$ 147,589

As of March 31, 2010, 64% of the leasable area at Northrock had been placed in operation. The development costs related to the area in operation have been reclassified to land and buildings. The costs reported in Construction in Progress above reflect the costs incurred as of March 31, 2010 and December 31, 2009, for the remaining 36% of the leasable area, as of both dates, respectively. As of March 31, 2010, 16% of the leasable area at Westview Village had been placed in operation. The development costs related to the area in operation have been reclassified to land and buildings. The costs reported in Construction in Progress above reflect the costs incurred as of March 31, 2010 and December 31, 2009, for the remaining 84% and 85% of the leasable area, respectively.

Accounts Receivable, Accrued Income and Allowance for Doubtful Accounts

Accounts receivable primarily represent amounts currently due from tenants in accordance with the terms of the respective leases. Receivables are reviewed monthly and reserves are established with a charge to current period operations when, in the opinion of management, collection of the receivable is doubtful. Accounts receivable in the accompanying financial statements are shown net of an allowance for doubtful accounts of approximately $854,000 and $1,265,000, at March 31, 2010 and December 31, 2009, respectively.

In addition to rents due currently, accounts receivable includes approximately $27,268,000 and $27,154,000, at March 31, 2010 and December 31, 2009, respectively, net of allowance for doubtful accounts totaling $26,000 and $15,000, respectively, representing minimum rental income accrued on a straight-line basis to be paid by tenants over the remaining term of their respective leases.

Cash and Cash Equivalents

Cash and cash equivalents include short-term investments. Short-term investments include money market accounts and other investments which generally mature within three months, measured from the acquisition date, and/or are readily convertible to cash. Substantially all of the Company s cash balances at March 31, 2010 are held in non-interest bearing accounts at various banks.

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Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

Deferred Debt Costs

Deferred debt costs consist of fees and costs incurred to obtain long-term financing, construction financing and the revolving line of credit. These fees and costs are being amortized on a straight-line basis over the terms of the respective loans or agreements, which approximates the effective interest method. Deferred debt costs totaled $7,291,000 and $7,537,000, net of accumulated amortization of $4,674,000 and $5,161,000, at March 31, 2010 and December 31, 2009, respectively.

Deferred Income

Deferred income consists of payments received from tenants prior to the time they are earned and recognized by the Company as revenue, including tenant prepayment of rent for future periods, real estate taxes when the taxing jurisdiction has a fiscal year differing from the calendar year reimbursements specified in the lease agreement and tenant construction work provided by the Company. In addition, deferred income includes the fair value of certain below market leases.

Revenue Recognition

Rental and interest income is accrued as earned except when doubt exists as to collectability, in which case the accrual is discontinued. Recognition of rental income commences when control of the space has been given to the tenant. When rental payments due under leases vary from a straight-line basis because of free rent periods or scheduled rent increases, income is recognized on a straight-line basis. Expense recoveries represent a portion of property operating expenses billed to tenants, including common area maintenance, real estate taxes and other recoverable costs. Expense recoveries are recognized in the period when the expenses are incurred. Rental income based on a tenant s revenue (percentage rent) is accrued when a tenant reports sales that exceed a specified breakpoint, pursuant to the terms of their respective leases.

Income Taxes

The Company made an election to be treated, and intends to continue operating so as to qualify, as a REIT under the Code, commencing with its taxable year ended December 31, 1993. A REIT generally will not be subject to federal income taxation, provided that distributions to its stockholders equal or exceed its REIT taxable income and complies with certain other requirements. Therefore, no provision has been made for federal income taxes in the accompanying consolidated financial statements.

Stock-based Employee Compensation, Deferred Compensation and Stock Plan for Directors

Effective January 2003, the Company adopted the fair value method to value and account for employee stock options using the prospective transition method. The Company had no options eligible for valuation prior to the grant of options in 2003. The fair value of options granted is determined at the time of each award using the Black-Scholes model, a widely used

Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

method for valuing stock based employee compensation, and the following assumptions: (1) Expected Volatility determined using the most recent trading history of the Company s common stock (month-end closing prices) corresponding to the average expected term of the options; (2) Average Expected Term of the options is based on prior exercise history, scheduled vesting and the expiration date; (3) Expected Dividend Yield determined by management after considering the Company s current and historic dividend yield rates, the Company s yield in relation to other retail REITs and the Company s market yield at the grant date; and (4) a Risk-free Interest Rate based upon the market yields of US Treasury obligations with maturities corresponding to the average expected term of the options at the grant date. The Company amortizes the value of options granted ratably over the vesting period and includes the amounts as compensation in general and administrative expenses.

At the annual meeting of the Company s stockholders in 2004, the stockholders approved the adoption of the 2004 stock plan for the purpose of attracting and retaining executive officers, directors and other key personnel. The 2004 stock plan was subsequently amended by the Company s stockholders at the 2008 Annual Meeting (the Amended 2004 Plan) and expires in April 2018. Pursuant to the Amended 2004 Plan, the Compensation Committee established a Deferred Compensation Plan for Directors for the benefit of its directors and their beneficiaries, which replaced a previous Deferred Compensation and Stock Plan for Directors. A director may make an annual election to defer all or part of his or her director s fees and has the option to have the fees paid in cash, in shares of common stock or in a combination of cash and shares of common stock upon termination from the Board. If the director elects to have fees paid in stock, fees earned during a calendar quarter are aggregated and divided by the common stock s closing market price on the first trading day of the following quarter to determine the number of shares to be allocated to the director. As of March 31, 2010, 223,000 shares had been credited to the directors deferred fee accounts.

The Compensation Committee has also approved an annual award of shares of the Company s common stock as additional compensation to each director serving on the Board of Directors as of the record date for the Annual Meeting of Stockholders. The shares are awarded as of each Annual Meeting of Shareholders, and their issuance may not be deferred. Each director was issued 200 shares at the 2009 Annual Meeting of Shareholders. The shares were valued at the closing stock price on the date the shares were awarded and included in general and administrative expenses.

Noncontrolling Interest

Saul Centers is the sole general partner of the Operating Partnership, owning a 77.0% common interest as of March 31, 2010. Noncontrolling interest in the Operating Partnership is comprised of limited partnership units owned by The Saul Organization. Noncontrolling interest as reflected on the accompanying consolidated balance sheets is increased for earnings allocated to limited partnership interests and distributions reinvested in additional units, and is decreased for limited partner distributions. Noncontrolling interest as reflected on the consolidated statements of operations represent earnings allocated to limited partnership interests held by the Saul Organization.

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Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

Per Share Data

Per share data for net income (basic and diluted) is computed using weighted average shares of common stock. Convertible limited partnership units and employee stock options are the Company s potentially dilutive securities. For all periods presented, the convertible limited partnership units are non-dilutive. Certain options are dilutive because the average share price of the Company s common stock exceeded the exercise prices. The treasury stock method was used to measure the effect of the dilution.

Basic and Diluted Shares Outstanding

	Quarter ended March 31,	
(In thousands)	**2010**	**2009**
Weighted average common shares outstanding-Basic	18,084	17,870
Effect of dilutive options	82	30
Weighted average common shares outstanding-Diluted	18,166	17,900

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the current year presentation. The reclassifications have no impact on operating results previously reported.

Legal Contingencies

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. These matters are generally covered by insurance. Once it has been determined that a loss is probable to occur, the estimated amount of the loss is recorded in the financial statements.

New Accounting Standards

The Company adopted Accounting Standards Update (ASU) No. 2009-17 effective January 1, 2010, which changes the consolidation guidance applicable to variable interest entities (VIEs). It also amends the guidance governing the determination of whether an enterprise is the primary beneficiary of a VIE, and is therefore required to consolidate an entity, by requiring a qualitative analysis rather than a quantitative analysis. The qualitative analysis includes, among other things, consideration of who has the power to direct the activities of the entity that most significantly impact the entity s economic performance and who has the obligation to absorb losses or the right receive benefits of the VIE that could potentially be significant to the VIE. This topic also requires continuous reassessments of whether an enterprise is the primary beneficiary of a VIE. The adoption did not have a material impact on the Company s consolidated financial statements.

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Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

3. Real Estate Acquired or Developed

Westview Village

In November 2007, the Company purchased for $5.0 million a land parcel in the Westview development in Frederick, Maryland. In 2009, the Company substantially completed construction of a neighborhood retail and office center.

Northrock

In January 2008, the Company purchased for $12.5 million an undeveloped land parcel in Warrenton, Virginia. In 2009, the Company substantially completed construction of a neighborhood shopping center which is anchored by a Harris Teeter supermarket.

4. Noncontrolling Interest - Holders of Convertible Limited Partnership Units in the Operating Partnership

Certain members of The Saul Organization are limited partners of the Operating Partnership, collectively owning a 23.0% common interest as of March 31, 2010, represented by approximately 5,416,000 convertible limited partnership units. These units are convertible into shares of Saul Centers common stock, at the option of the unit holder, on a one-for-one basis provided that, in accordance with the Saul Centers, Inc. Articles of Incorporation, the rights may not be exercised at any time that The Saul Organization beneficially owns, directly or indirectly, in the aggregate more than 39.9% of the value of the outstanding common stock and preferred stock of Saul Centers (the Equity Securities). As of March 31, 2010, all 5,416,000 units were convertible into shares of Saul Centers common stock.

The impact of The Saul Organization s approximately 23.0% limited partnership interest in the Operating Partnership is reflected as Noncontrolling Interest in the accompanying consolidated financial statements. Fully converted partnership units and diluted weighted average shares outstanding for the quarters ended March 31, 2010 and 2009, were approximately 23,582,000 and 23,316,000, respectively.

5. Mortgage Notes Payable, Revolving Credit Facility, Interest and Amortization of Deferred Debt Costs

The Company s outstanding debt totaled approximately $643,996,000 at March 31, 2010, of which approximately $572,236,000 was fixed-rate debt and approximately $71,760,000 was variable rate debt.

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Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

In addition to the outstanding indebtedness at March 31, 2010, the Company had a $150 million unsecured revolving credit facility, which can be used for working capital, property acquisitions or development projects, with no outstanding borrowings. The revolving credit facility matures on June 30, 2012, and may be extended by the Company for one additional year subject to the Company s satisfaction of certain conditions. Saul Centers and certain consolidated subsidiaries of the Operating Partnership have guaranteed the payment obligations of the Operating Partnership under the revolving credit facility. Letters of credit may be issued under the revolving credit facility. On March 31, 2010, of the $150,000,000 available for borrowing, approximately $224,000 was committed for letters of credit and approximately $149,776,000 was available under the line. Interest rate pricing under the facility is primarily determined by operating income from the Company s existing unencumbered properties and, to a lesser extent, certain leverage tests. As of March 31, 2010, operating income from the unencumbered properties determined the interest rate for up to $104,000,000 of the line s available borrowings, with interest expense to be calculated based upon the 1, 2, 3 or 6 month LIBOR plus a spread of 3.65% to 3.90%. The interest rate on the remaining $46,000,000 of the line s availability is determined based upon the Company s consolidated operating income after debt service. On this portion of the facility, interest accrues at a rate of LIBOR plus a spread of 4.45% to 5.25%, determined by certain leverage tests. The Company may elect to use the 1, 2, 3 or 6 month LIBOR, but in no event shall LIBOR be less than 1.5%.

Saul Centers is a guarantor of the revolving credit facility, of which the Operating Partnership is the borrower. Saul Centers is also the guarantor of 50% of the Northrock construction loan (approximately $9,667,000 of the $19,334,000 outstanding at March 31, 2010) and the Clarendon Center construction loan (approximately $52,426,000 outstanding at March 31, 2010). The fixed-rate notes payable are all non-recourse debt except for $3,882,000 of the Great Falls Center mortgage, which is guaranteed by Saul Centers.

At December 31, 2009, the Company s outstanding debt totaled approximately $636,806,000, of which $576,069,000 was fixed rate and $60,737,000 was variable rate debt. and no balances were outstanding on the Company s $150,000,000 unsecured revolving credit facility.

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Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

At March 31, 2010, the scheduled maturities of all debt, including scheduled principal amortization, for years ending December 31, were as follows:

Debt Maturity Schedule

(Dollars in thousands)	Balloon Payments	Scheduled Principal Amortization	Total
April 1 through December 31, 2010	$	$ 11,842	$ 11,842
2011	71,760(a)	16,823	88,583
2012	96,300	17,028	113,328
2013	39,440	11,404	50,844
2014	13,176	11,354	24,530
2015	15,012	11,459	26,471
Thereafter	252,470	75,928	328,398
	$ 488,158	$ 155,838	$ 643,996

(a) Represents the Clarendon Center and Northrock construction loan balances as of March 31, 2010.

Interest expense and amortization of deferred debt costs for the quarters ended March 31, 2010 and 2009, were as follows:

Interest Expense and Amortization of Deferred Debt Costs

(Dollars in thousands)	Quarter ended March 31, 2010	2009
Interest incurred	$ 10,052	$ 9,256
Amortization of deferred debt costs	367	299
Capitalized interest	(1,828)	(1,359)
	$ 8,591	$ 8,196

6. Stockholders Equity and Noncontrolling Interest

The consolidated statements of operations for the three months ended March 31, 2010 and 2009 reflect noncontrolling interest of $2,021,000 and $1,809,000, respectively, representing The Saul Organization s share of net income for each period.

In November 2003, the Company sold 4,000,000 depositary shares, each representing 1/100th of a share of 8% Series A Cumulative Redeemable Preferred Stock. The depositary shares are redeemable, in whole or in part at the Company s option, from time to time, at $25.00 per share. The depositary shares pay an annual dividend of $2.00 per share, equivalent to 8% of the $25.00 per share liquidation preference. The Series A preferred stock has no stated maturity, is not subject to any sinking fund or mandatory redemption and is not convertible into any other securities of the Company. Investors in the depositary shares generally have no voting rights, but will have limited voting rights if the Company fails to pay dividends for six or more quarters (whether or not declared or consecutive) and in certain other events.

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Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

In March 2008, the Company sold 3,173,115 depositary shares, each representing 1/100th of a share of 9% Series B Cumulative Redeemable Preferred Stock. The depositary shares may be redeemed at the Company s option, on or after March 15, 2013, in whole or in part, at $25.00 per share . The depositary shares pay an annual dividend of $2.25 per share, equivalent to 9% of the $25.00 per share liquidation preference. The Series B preferred stock has no stated maturity, is not subject to any sinking fund or mandatory redemption and is not convertible into any other securities of the Company. Investors in the depositary shares generally have no voting rights, but will have limited voting rights if the Company fails to pay dividends for six or more quarters (whether or not declared or consecutive) and in certain other events.

7. Related Party Transactions

The Chairman and Chief Executive Officer, the President, the Senior Vice President- General Counsel and the Senior Vice President-Chief Accounting Officer of the Company are also officers of various members of The Saul Organization and their management time is shared with The Saul Organization. Their annual compensation is fixed by the Compensation Committee of the Board of Directors, with the exception of the Senior Vice President-Chief Accounting Officer whose share of annual compensation allocated to the Company is determined by the shared services agreement (described below).

The Company participates in a multiemployer 401K plan with entities in The Saul Organization which covers those full-time employees who meet the requirements as specified in the plan. Company contributions, which are included in general and administrative expense or property operating expenses in the consolidated statements of operations, at the discretionary amount of up to six percent of the employee s cash compensation, subject to certain limits, were $94,000 and $125,000, for the three months ended March 31, 2010 and 2009, respectively. All amounts deferred by employees and the Company are fully vested.

The Company also participates in a multiemployer nonqualified deferred compensation plan with entities in The Saul Organization which covers those full-time employees who meet the requirements as specified in the plan. According to the plan, which can be modified or discontinued at any time, participating employees defer 2% of their compensation in excess of a specified amount. For the three months ended March 31, 2010 and 2009, the Company contributed three times the amount deferred by employees. The Company s expense, included in general and administrative expense, totaled $49,000 and $51,000, for the three months ended March 31, 2010 and 2009, respectively. All amounts deferred by employees and the Company are fully vested. The cumulative unfunded liability under this plan was $1,423,000 and $1,371,000, at March 31, 2010 and December 31, 2009, respectively, and is included in accounts payable, accrued expenses and other liabilities in the consolidated balance sheets.

The Company has entered into a shared services agreement (the Agreement) with The Saul Organization that provides for the sharing of certain personnel and ancillary functions such as computer hardware, software, and support services and certain direct and indirect administrative personnel. The method for determining the cost of the shared services is provided

Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

for in the Agreement and is based upon head count, estimates of usage or estimates of time incurred, as applicable. The terms of the Agreement and the payments made thereunder are deemed reasonable by management and are reviewed annually by the Audit Committee of the Board of Directors, which consists entirely of independent directors. Billings by The Saul Organization for the Company s share of these ancillary costs and expenses for the three months ended March 31, 2010 and 2009, which included rental expense for the Company s headquarters lease, totaled approximately $1,514,000 and $1,423,000, respectively. The amounts are expensed as incurred and are primarily reported as general and administrative expenses in these consolidated financial statements. As of March 31, 2010 and December 31, 2009, accounts payable, accrued expenses and other liabilities included approximately $365,000 and $525,000, respectively, representing amounts due to The Saul Organization for the Company s share of these ancillary costs and expenses.

The Company s corporate headquarters space is leased by a member of The Saul Organization. The 10-year lease, which commenced in March 2002, provides for base rent increases of 3% per year, with payment of a pro-rata share of operating expenses over a base year amount. The Company and The Saul Organization entered into a Shared Services Agreement whereby each party pays an allocation of total rental payments based on a percentage proportionate to the number of employees employed by each party. The Company s rent expense for the three months ended March 31, 2010 and 2009 was approximately $215,000 and $210,000, respectively, and is included in general and administrative expense.

The B. F. Saul Insurance Agency of Maryland, Inc., a subsidiary of the B. F. Saul Company and a member of The Saul Organization, is a general insurance agency that receives commissions and fees in connection with the Company s insurance program. Such commissions and fees amounted to $48,000 and $50,000 for the three months ended March 31, 2010 and 2009, respectively.

8. Stock Option Plans

The Company has established two stock incentive plans, the 1993 plan and the 2004 plan (together, the Plans). Under the Plans, options were granted at an exercise price not less than the market value of the common stock on the date of grant and expire ten years from the date of grant. Officer options vest ratably over four years following the grant and are expensed straight-line over the vesting period. Director options vest immediately and are expensed as of the date of grant.

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Saul Centers, Inc.

Notes to Consolidated Financial Statements (Unaudited) (Continued)

The following table summarizes the amount and activity of each grant, the total value and variables used in the computation and the amount expensed and included in general and administrative expense in the Consolidated Statements of Operations for the three months ended March 31, 2010:

Stock options issued

	Officers					**Directors**							
Grant date	**05/23/2003**	**04/26/2004**	**05/06/2005**	**04/27/2007**	**Subtotals**	**04/26/2004**	**05/06/2005**	**05/01/2006**	**04/27/2007**	**04/25/2008**	**04/24/2009**	**Subtotals**	**Grand Totals**
Total grant	220,000	122,500	132,500	135,000	610,000	30,000	30,000	30,000	30,000	30,000	32,500	182,500	**792,500**
Vested	212,500	115,000	118,750	61,250	507,500	30,000	30,000	30,000	30,000	30,000	32,500	182,500	**690,000**
Exercised	103,019	34,375	6,250		143,644	6,200	2,500					8,700	**152,344**
Forfeited	7,500	7,500	13,750	12,500	41,250								**41,250**
Exercisable at March 31, 2010	109,481	80,625	112,500	61,250	363,856	23,800	27,500	30,000	30,000	30,000	32,500	173,800	**537,656**
Remaining unexercised	109,481	80,625	112,500	122,500	425,106	23,800	27,500	30,000	30,000	30,000	32,500		