

SAUL CENTERS INC  
Form 10-Q  
August 09, 2007  
Table of Contents

---

**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 QUARTER ENDED June 30, 2007**  
**COMMISSION FILE NUMBER 1-12254**

---

**SAUL CENTERS, INC.**

(Exact name of registrant as specified in its charter)

---

<b>Maryland</b> (State or other jurisdiction of incorporation or organization)	<b>52-1833074</b> (I.R.S. Employer Identification No.)
<b>7501 Wisconsin Avenue, Bethesda, Maryland 20814</b>  (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  NO

## Edgar Filing: SAUL CENTERS INC - Form 10-Q

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

Large accelerated filer  Accelerated filer  Non-accelerated filer .

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

Number of shares of common stock, par value \$0.01 per share outstanding as of August 9, 2007: 17,723,000

---

**Table of Contents**

**SAUL CENTERS, INC.**

Table of Contents

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
Item 1. <u>Financial Statements (Unaudited)</u>	
(a) <u>Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006</u>	4
(b) <u>Consolidated Statements of Operations for the three and six months ended June 30, 2007 and 2006</u>	5
(c) <u>Consolidated Statements of Stockholders' Equity as of June 30, 2007 and December 31, 2006</u>	6
(d) <u>Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and 2006.</u>	7
(e) Notes to Consolidated Financial Statements	8
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
(a) <u>Critical Accounting Policies</u>	27
(b) <u>Results of Operations</u>	
<u>Three months ended June 30, 2007 compared to three months ended June 30, 2006</u>	29
<u>Six months ended June 30, 2007 compared to six months ended June 30, 2006</u>	32
(c) <u>Liquidity and Capital Resources</u>	34
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	44
Item 4. <u>Controls and Procedures</u>	44
<b><u>PART II. OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	45
Item 1A. <u>Risk Factors</u>	45
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	45
Item 3. <u>Defaults Upon Senior Securities</u>	45
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	46
Item 5. <u>Other Information</u>	46
Item 6. <u>Exhibits</u>	46

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**  
**Basis of Presentation**

In the opinion of management, the accompanying consolidated financial statements reflect all adjustments necessary for the fair presentation of the financial position and results of operations of Saul Centers, Inc. for the interim periods. 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, 2006, 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.

**Table of Contents**

Saul Centers, Inc.

**CONSOLIDATED BALANCE SHEETS**

<i>(Dollars in thousands, except per share amounts)</i>	<b>June 30, 2007 (Unaudited)</b>	<b>December 31, 2006 (Unaudited)</b>
<b>Assets</b>		
Real estate investments		
Land	\$ 157,830	\$ 154,047
Buildings and equipment	652,201	631,797
Construction in progress	46,505	56,017
	856,536	841,861
Accumulated depreciation	(223,652)	(214,210)
	632,884	627,651
Cash and cash equivalents	11,535	8,061
Accounts receivable and accrued income, net	30,458	33,248
Deferred leasing costs, net	16,363	18,137
Prepaid expenses, net	1,349	2,507
Deferred debt costs, net	5,266	5,328
Other assets	9,012	5,605
<b>Total assets</b>	<b>\$ 706,867</b>	<b>\$ 700,537</b>
<b>Liabilities</b>		
Mortgage notes payable	\$ 520,345	\$ 487,443
Revolving credit facility outstanding		35,000
Dividends and distributions payable	12,115	11,558
Accounts payable, accrued expenses and other liabilities	15,029	16,409
Deferred income	11,273	12,251
<b>Total liabilities</b>	<b>558,762</b>	<b>562,661</b>
<b>Minority interests</b>	<b>5,305</b>	<b>5,785</b>
<b>Stockholders' equity</b>		
Series A Cumulative Redeemable Preferred stock, 1,000,000 shares authorized and 40,000 shares issued and outstanding	100,000	100,000
Common stock, \$0.01 par value, 30,000,000 shares authorized, 17,572,708 and 17,341,441 shares issued and outstanding, respectively	176	173
Additional paid-in capital	153,870	141,554
Accumulated deficit	(111,246)	(109,636)
<b>Total stockholders' equity</b>	<b>142,800</b>	<b>132,091</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 706,867</b>	<b>\$ 700,537</b>

The accompanying notes are an integral part of these statements



**Table of Contents**

Saul Centers, Inc.

**CONSOLIDATED STATEMENTS OF OPERATIONS***(Unaudited)*

<i>(Dollars in thousands, except per share amounts)</i>	<b>For The Three Months Ended June 30,</b>		<b>For The Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Revenue</b>				
Base rent	\$ 29,531	\$ 27,190	\$ 58,552	\$ 54,090
Expense recoveries	6,282	5,407	12,880	10,920
Percentage rent	312	272	514	598
Other	952	879	1,815	1,607
<b>Total revenue</b>	<b>37,077</b>	<b>33,748</b>	<b>73,761</b>	<b>67,215</b>
<b>Operating expenses</b>				
Property operating expenses	4,343	3,963	9,148	7,931
Provision for credit losses	103	107	215	187
Real estate taxes	3,538	2,994	7,064	6,046
Interest expense and amortization of deferred debt	8,325	8,072	16,619	16,091
Depreciation and amortization of deferred leasing costs	6,503	6,400	12,951	12,776
General and administrative	3,188	2,564	5,678	5,027
<b>Total operating expenses</b>	<b>26,000</b>	<b>24,100</b>	<b>51,675</b>	<b>48,058</b>
<b>Operating income before minority interests</b>	<b>11,077</b>	<b>9,648</b>	<b>22,086</b>	<b>19,157</b>
<b>Minority interests</b>				
Minority share of income	(2,151)	(1,851)	(4,286)	(3,653)
<b>Net income</b>	<b>8,926</b>	<b>7,797</b>	<b>17,800</b>	<b>15,504</b>
Preferred dividends	(2,000)	(2,000)	(4,000)	(4,000)
<b>Net income available to common stockholders</b>	<b>\$ 6,926</b>	<b>\$ 5,797</b>	<b>\$ 13,800</b>	<b>\$ 11,504</b>
<b>Per share net income available to common stockholders</b>				
Basic	\$ 0.40	\$ 0.34	\$ 0.79	\$ 0.68
Diluted	\$ 0.39	\$ 0.34	\$ 0.78	\$ 0.67
<b>Distributions declared per common share outstanding</b>	<b>\$ 0.44</b>	<b>\$ 0.42</b>	<b>\$ 0.88</b>	<b>\$ 0.84</b>

The accompanying notes are an integral part of these statements

**Table of Contents**

Saul Centers, Inc.

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY***(Unaudited)**(Dollars in thousands,*

<i>except per share amounts)</i>	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total
<b>Stockholders equity:</b>					
Balance, December 31, 2006	\$ 100,000	\$ 173	\$ 141,554	\$ (109,636)	\$ 132,091
Issuance of 108,888 shares of common stock:					
107,553 shares due to dividend reinvestment plan		2	5,612		5,614
1,335 shares due to employee stock options and directors' deferred stock plan and stock option awards			131		131
Net income				8,874	8,874
Distributions payable preferred stock (\$50.00 per share)				(2,000)	(2,000)
Distributions payable common stock (\$0.44 per share)				(7,678)	(7,678)
Balance, March 31, 2007	100,000	175	147,297	(110,440)	137,032
Issuance of 122,379 shares of common stock:					
113,165 shares due to dividend reinvestment plan		1	5,837		5,838
9,214 shares due to employee stock options and directors' deferred stock plan and stock option awards			736		736
Net income				8,926	8,926
Distributions payable preferred stock (\$50.00 per share)				(2,000)	(2,000)
Distributions payable common stock (\$0.44 per share)				(7,732)	(7,732)
Balance, June 30, 2007	\$ 100,000	\$ 176	\$ 153,870	\$ (111,246)	\$ 142,800

The accompanying notes are an integral part of these statements



**Table of Contents**

Saul Centers, Inc.

**CONSOLIDATED STATEMENTS OF CASH FLOWS***(Unaudited)*

	<b>For The Six Months</b>	
	<b>Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
<i>(Dollars in thousands)</i>		
<b>Cash flows from operating activities:</b>		
Net income	\$ 17,800	\$ 15,504
Adjustments to reconcile net income to net cash provided by operating activities:		
Minority interests	4,286	3,653
Depreciation and amortization of deferred leasing costs	12,951	12,776
Amortization of deferred debt costs	555	540
Non cash compensation costs from stock grants and options	720	545
Provision for credit losses	215	187
Decrease in accounts receivable and accrued income	2,575	124
Increase in deferred leasing costs	(1,303)	(1,223)
Decrease in prepaid expenses	1,158	1,067
Increase in other assets	(3,407)	(2,609)
Increase in accounts payable, accrued expenses and other liabilities	2,243	2,615
Decrease in deferred income	(978)	(223)
<b>Net cash provided by operating activities</b>	<b>36,815</b>	<b>32,956</b>
<b>Cash flows from investing activities:</b>		
Acquisitions of real estate investments, net*	(1,333)	(17,618)
Additions to real estate investments	(3,863)	(8,392)
Additions to development and redevelopment activities	(13,534)	(16,303)
<b>Net cash used in investing activities</b>	<b>(18,730)</b>	<b>(42,313)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from notes payable	40,000	10,500
Repayments on notes payable	(7,098)	(6,523)
Proceeds from revolving credit facility		20,000
Repayments on revolving credit facility	(35,000)	(4,500)
Additions to deferred debt costs	(493)	(510)
Proceeds from the issuance of:		
Common Stock	11,599	4,126
Convertible limited partnership units in the Operating Partnership		4,001
Distributions to:		
Preferred stockholders	(4,000)	(4,000)
Common stockholders	(14,961)	(14,215)
Convertible limited partnership units in the Operating Partnership	(4,658)	(4,484)
<b>Net cash (used) provided by financing activities</b>	<b>(14,611)</b>	<b>4,395</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>3,474</b>	<b>(4,962)</b>
Cash and cash equivalents, beginning of period	8,061	8,007

Edgar Filing: SAUL CENTERS INC - Form 10-Q

Cash and cash equivalents, end of period	\$ 11,535	\$ 3,045
--	-----------	----------

---

\* Supplemental discussion of non-cash investing and financing activities:

On January 27, 2006 the Company paid \$17,815 for the acquisition Smallwood Village Center by assuming an \$11,334 mortgage loan and paid cash of \$6,481.

The accompanying notes are an integral part of these statements

-7-

**Table of Contents****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). Saul Centers generally will not be subject to federal income tax, provided it annually distributes at least 90% of its REIT taxable income to its stockholders and meets 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, Chevy Chase Bank, F.S.B. and certain other affiliated entities, each of which is 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 developed and acquired by the Company since December 31, 2004. All of the following properties are operating shopping centers (Shopping Centers).

Name of Property	Location	Square Footage	Date of Acquisition/Development
<i>Acquisitions</i>			
Palm Springs Center	Altamonte Springs, FL	126,000	2005
Jamestown Place	Altamonte Springs, FL	96,000	2005
Seabreeze Plaza	Palm Harbor, FL	147,000	2005
Smallwood Village Center	Waldorf, MD	198,000	2006
Hunt Club Corners	Apopka, FL	101,000	2006
<i>Developments</i>			
Kentlands Place	Gaithersburg, MD	41,000	2005
Broadlands Village Phase III	Ashburn, VA	22,000	2006
Lansdowne Town Center	Leesburg, VA	188,000	2006/7

As of June 30, 2007, the Company's properties (the Current Portfolio Properties) consisted of 42 operating shopping center properties (the Shopping Centers), five predominantly office operating properties (the Office Properties) and four (non-operating) development properties.

## **Table of Contents**

The Company established Saul QRS, Inc., a wholly owned subsidiary of Saul Centers, to facilitate the placement of collateralized mortgage debt in September 1997. 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.

## **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 June 30, 2007, twenty-seven of the Shopping Centers were anchored by a grocery store and offer primarily day-to-day necessities and services. No single property accounted for more than 7.2% of the total gross leasable area. Only two retail tenants, Giant Food (4.7%), a tenant at nine Shopping Centers and Safeway (3.0%), a tenant at seven Shopping Centers and one office tenant, the United States Government (2.8%), a tenant at six properties, individually accounted for more than 2.5% of the Company's total revenue for the six months ended June 30, 2007.

### **Principles of Consolidation**

The accompanying consolidated financial statements of the Company include the accounts of Saul Centers, its subsidiaries, and 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**

In the opinion of management, the accompanying consolidated financial statements reflect all adjustments necessary for the fair presentation of the financial position and results of operations of Saul Centers for the interim periods. 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 for the year ended December 31, 2006, 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.

## **Table of Contents**

### **Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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.

### **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 in accordance with Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) 141, Business Combinations. The purchase price is allocated based on the relative 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 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 lease expense over the remaining contractual lease term. To the extent customer relationship intangibles are present in an acquisition, the fair value of the intangibles are amortized over the life of the customer relationship.

Real estate investment properties, including properties under development and land held for future development, are reviewed for potential impairment losses quarterly or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If there is an event or change in circumstance indicating the potential for an impairment in the value of a real estate investment property, the Company's policy is to assess potential impairment in value by making a comparison of the current and projected cash flows of the property over its remaining useful life, on an undiscounted basis, to the carrying amount of that property and estimated cash flows associated with future development expenditures. If such carrying amount is in excess of the estimated projected cash flows of the assets, the Company would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its estimated fair market value. The Company has not recognized an impairment loss on any of its real estate.

## **Table of Contents**

Interest, real estate taxes 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 totaled \$1,624,000 and \$1,652,000, for the six month periods ended June 30, 2007 and 2006, respectively. In the initial rental operations of development projects, 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, we capitalize leasehold improvements when certain criteria are met, including when we supervise construction and will own the improvement. Leasehold improvements are amortized, over the shorter of the lives of the related leases or the useful life of the improvement, using the straight-line method. The depreciation component included in depreciation and amortization expense in the consolidated statements of operations, totaled \$10,492,000 and \$9,958,000, for the six month periods ended June 30, 2007 and 2006, respectively. Repair and maintenance expense, included in property operating expenses for the six month periods ended June 30, 2007 and 2006, was \$4,549,000 and \$3,594,000, respectively.

## **Deferred Leasing Costs**

Certain initial direct costs incurred by the Company in negotiating and consummating a successful lease are capitalized and amortized over the initial base term of the lease. These costs total \$16,363,000 and \$18,137,000, net of accumulated amortization of \$13,853,000 and \$13,308,000, as of June 30, 2007 and December 31, 2006, respectively. Amortization expense, included in depreciation and amortization in the consolidated statements of operations, totaled \$2,459,000 and \$2,818,000, for the six months ended June 30, 2007 and 2006, respectively. Deferred leasing costs consist of commissions paid to third party leasing agents as well as internal direct costs such as employee compensation and payroll related fringe benefits directly related to time spent performing leasing related activities for successful leases. Such 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.

## **Construction In Progress**

Construction in progress includes preconstruction costs and development costs of active projects. Preconstruction costs associated with these active 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

**Table of Contents**

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 June 30, 2007 and December 31, 2006 are as follows:

**Construction in Progress**

<i>(Dollars in thousands)</i>	<b>June 30,</b>	<b>December 31,</b>
	<b>2007</b>	<b>2006</b>
Clarendon Center	\$ 23,917	\$ 20,431
Lansdowne Town Center	6,859	19,972
Ashland Square	10,224	8,878
Ashburn Village Phase V		1,846
Lexington Center	2,668	2,480
Other	2,837	2,410
<b>Total</b>	<b>\$ 46,505</b>	<b>\$ 56,017</b>

As of June 30, 2007 and December 31, 2006, 83% and 45% of Lansdowne Town Center's leasable area had been placed in operation, respectively (approximately 156,000 and 85,000 square feet of space, respectively). The development costs related to the area in operation have been classified to land and buildings. The costs reported in Construction in Progress above reflect the costs incurred as of June 30, 2007 and December 31, 2006 for the remaining 17% and 55% of the project, respectively.

As of June 30, 2007, all of the Ashburn Village Phase V leasable area has been placed in operation (approximately 10,400 square feet). The development costs related to this area in operation have been classified to buildings.

**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 when, in the opinion of management, collection of the entire receivable is doubtful, revenue accrual is discontinued and an allowance for doubtful accounts is established. Accounts receivable in the accompanying financial statements are shown net of an allowance for doubtful accounts of \$348,000 and \$479,000, at June 30, 2007 and December 31, 2006, respectively.

In addition to rents due currently, accounts receivable include \$24,158,000 and \$23,341,000, at June 30, 2007 and December 31, 2006, respectively, representing minimum rental income accrued on a straight-line basis to be paid by tenants over the remaining term of their respective leases. These amounts are presented after netting allowances of \$213,000 and \$213,000, respectively, for tenants whose rent payment history or financial condition cast doubt upon the tenant's ability to perform under its lease obligations.

## **Table of Contents**

### **Cash and Cash Equivalents**

Cash and cash equivalents include short-term investments. Short-term investments are highly liquid investments that are both readily convertible to cash or so near their maturity that they present insignificant risk of changes in value arising from interest rate fluctuations. Short-term investments include money market accounts and other investments which generally mature within three months, measured from the acquisition date.

### **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 amortized over the terms of the respective loans or agreements, which approximates the effective interest method. Deferred debt costs totaled \$5,266,000 and \$5,328,000, and are presented net of accumulated amortization of \$4,798,000 and \$4,244,000, at June 30, 2007 and December 31, 2006, 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. These payments include prepayment of the following month's rent, prepayment of real estate taxes when the taxing jurisdiction has a fiscal year differing from the calendar year reimbursements specified in the lease agreement and advance payments by tenants for tenant construction work provided by the Company. In addition, deferred income includes the fair value of a below market lease component associated with acquisition properties as determined pursuant to the application of SFAS 141 Business Combinations .

### **Revenue Recognition**

Rental and interest income is accrued as earned except when doubt exists as to collectibility, 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 throughout the initial term of the lease. 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 revenues, known as percentage rent, is accrued when a tenant reports sales that exceed a specified breakpoint.

### **Income Taxes**

The Company made an election to be treated, and intends to continue operating so as to qualify as a REIT under the Internal Revenue Code, commencing with its taxable year ended December 31, 1993. A REIT generally will not be subject to federal income taxation on that portion of its income that qualifies as REIT taxable income to the extent that it distributes at least 90% of its REIT taxable income to stockholders and complies with certain other requirements. Therefore, no provision has been made for federal income taxes in the accompanying consolidated financial statements.



## **Table of Contents**

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 is an interpretation of FASB Statement No. 109, Accounting for Income Taxes, and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN 48 requires expanded disclosure with respect to the uncertainty in income taxes and is effective as of the beginning of the 2007 reporting year. The Company has evaluated the impact that FIN 48 has on the Company's financial statements, and as of January 1, 2007, has determined that the adoption of FIN 48 did not impact its financial condition or results of operations. Further, as of June 30, 2007, the Company had no material unrecognized tax benefits. The Company recognizes penalties and interest accrued related to unrecognized tax benefits, if any, as general and administrative expense. With few exceptions, the Company is no longer subject to U.S. federal, state, and local tax examinations by tax authorities for years before 2003.

### **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 specified under SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure and accounts for stock based compensation according to SFAS No. 123R. 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 method for valuing stock based employee compensation, and the following assumptions: (1) Expected Volatility. Expected volatility is 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. The options are assumed to be outstanding for a term calculated considering prior exercise history, scheduled vesting and the expiration date, (3) Expected Dividend Yield. This rate is a value management determines 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) Risk-free Interest Rate. This rate is 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.

The Company established a stock option plan in 1993 (the 1993 Plan) for the purpose of attracting and retaining executive officers and other key personnel. The 1993 Plan provided for grants of options to purchase a specified number of shares of common stock. A total of 400,000 shares were made available under the 1993 Plan. The 1993 Plan authorized the Compensation Committee of the Board of Directors to grant options at an exercise price not less than the market value of the common stock on the date the option is granted. Following a May 23, 2003 grant of shares, no additional shares remained for issuance under the 1993 Plan.

At the annual meeting of the Company's stockholders in 2004, the stockholders approved the adoption of the 2004 stock plan (the 2004 Plan) for the purpose of attracting and retaining

## **Table of Contents**

executive officers, directors and other key personnel. The 2004 Plan provides for grants of options to purchase up to 500,000 shares of common stock as well as grants of up to 100,000 shares of common stock to directors. The 2004 Plan authorizes the Compensation Committee of the Board of Directors to grant options at an exercise price which may not be less than the market value of the common stock on the date the option is granted.

Pursuant to the 2004 Plan, the Compensation Committee established a Deferred Compensation Plan for Directors for the benefit of its directors and their beneficiaries. The 2004 Plan replaced the Company's previous Deferred Compensation and Stock Plan for Directors. A director may elect 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 June 30, 2007, 209,000 shares had been allocated to the directors pursuant to the deferred compensation plans.

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, as of the 2007 Annual Meeting of Shareholders and for each of the years ended December 31, 2006, 2005 and 2004, respectively. The shares were valued at the closing stock price on the dates the shares were awarded and the total value is included in general and administrative expenses for the period of the award.

## **Minority Interests**

Saul Centers is the sole general partner of the Operating Partnership, owning a 76.4% common interest as of June 30, 2007. Minority Interests in the Operating Partnership are comprised of limited partnership units owned by The Saul Organization. Minority Interests as reflected on the Balance Sheets are increased for earnings allocated to limited partnership interests, distributions reinvested in additional units and in certain situations for distributions to minority interests in excess of earnings allocated, and are decreased for limited partner distributions. Minority Interests as reflected on the Statements of Operations represent earnings allocated to limited partnership interests. Amounts distributed in excess of the limited partners' share of earnings, net of limited partner reinvestments of distributions, also increase minority interests expense in the respective period and are classified on the Statements of Operations as Distributions in excess of earnings to the extent such distributions in excess of earnings exceed the carrying amount of minority interests.

## **Per Share Data**

Per share data is calculated in accordance with SFAS No. 128, Earnings Per Share. 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 anti-dilutive. The options are currently dilutive because the average share price of the Company's common stock exceeds the exercise prices. The treasury stock method was used to measure the effect of the dilution.

**Table of Contents****Basic and Diluted Shares Outstanding**

<i>(In thousands)</i>	Quarter ended June 30, Six months ended June 30,			
	2007	2006	2007	2006
Weighted average common shares outstanding-Basic	17,531	16,993	17,473	16,952
Effect of dilutive options	176	132	190	142
<b>Weighted average common shares outstanding-Diluted</b>	<b>17,707</b>	<b>17,125</b>	<b>17,663</b>	<b>17,094</b>

**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.

**Recent Accounting Pronouncements**

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 ( SFAS No. 159 ). This standard permits entities to choose to measure many financial instruments and certain other items at fair value and is effective for the first fiscal year beginning after November 15, 2007. The Company does not expect SFAS No. 159 to have a material impact on its financial statements.

**3. Real Estate Acquired***Smallwood Village Center*

On January 27, 2006, the Company acquired the 198,000 square foot Smallwood Village Center, located on 25 acres within the St. Charles planned community of Waldorf, Maryland, a suburb of metropolitan Washington, DC. The center is 78% leased as of June 30, 2007 and was acquired for a purchase price of \$17.5 million subject to the assumption of an \$11.3 million mortgage loan. The obligation assumed was treated as a non-cash acquisition in the Statement of Cash Flows. The Company has determined that the terms of the assumed mortgage did not materially differ from existing market rates and that the loan was fairly valued at acquisition.

## **Table of Contents**

### *Hunt Club Corners*

On June 1, 2006, the Company completed the acquisition of the 101,500 square foot Publix-anchored Hunt Club Corners shopping center located in Apopka, FL. The center is 100% leased as of June 30, 2007 and was acquired for a purchase price of \$11.1 million.

### *Great Eastern Plaza Land Parcel*

On June 6, 2007, the Company acquired 8.0 acres of undeveloped land adjacent to its Great Eastern Plaza shopping center in District Heights, Maryland, for a purchase price of \$1.3 million. The Company is analyzing options to expand the existing shopping center onto this parcel at some future date.

### *Application of SFAS 141, Business Combinations, for Real Estate Acquired*

The Company accounted for the operating property acquisitions using the purchase method of accounting in accordance with SFAS No. 141, Business Combinations. The Company allocates the purchase price to various components, such as land, buildings and intangibles related to in-place leases and customer relationships, if applicable, as described in Note 2.

## **4. Minority Interests - Holders of Convertible Limited Partner Units in the Operating Partnership**

The Saul Organization has a 23.6% limited partnership interest, represented by 5,416,000 convertible limited partnership units in the Operating Partnership, as of June 30, 2007. These convertible limited partnership 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").

The Operating Partnership issued 106,157 limited partnership units pursuant to the Dividend Reinvestment and Stock Purchase Plan at a weighted average discounted price of \$37.69 per share during the six month period ended June 30, 2006. No units were issued during the corresponding 2007 period.

The impact of The Saul Organization's 23.6% limited partnership interest in the Operating Partnership is reflected as minority interests in the accompanying consolidated financial statements. Fully converted partnership units and diluted weighted average shares outstanding for the six months ended June 30, 2007 and 2006, were 23,065,000 and 22,468,000, respectively.

---

**Table of Contents**

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

The Company's outstanding debt totaled \$520,345,000 at June 30, 2007, all of which was fixed rate mortgage debt. No balance was outstanding on the Company's variable rate, \$150,000,000 unsecured revolving credit facility. The facility provides working capital and funds for acquisitions, certain developments and redevelopments, has a three-year term expiring on January 27, 2008 and provides for an additional one-year extension at the Company's option, subject to the Company's satisfaction of certain conditions. Letters of credit may be issued under the revolving credit facility. The facility requires monthly interest payments, if applicable, at a rate of LIBOR plus a spread of 1.40% to 1.625% (determined by certain leverage tests) or upon the bank's reference rate at the Company's option.

Loan availability under the facility is determined by operating income from the Company's existing unencumbered properties. Based upon the terms of the facility, the unencumbered properties support line availability of \$90,000,000, of which \$2,127,000 has been issued under letters of credit, leaving \$87,873,000 available for working capital uses. An additional \$60,000,000 could become available for funding working capital and operating property acquisitions as unencumbered properties' internal cash flow grows and operating income is provided by future unencumbered acquisitions.

During the second quarter of 2007, Saul Centers was released as a guarantor for a portion of one of the Partnerships' mortgage notes payable totaling \$4,500,000. The guarantee was released upon the achievement of specified leasing thresholds at a recently redeveloped property. Saul Centers is a guarantor of the revolving credit facility, of which the Operating Partnership is the borrower. The mortgage notes payable totaling \$520,345,000 are non-recourse.

On May 30, 2007, the Company closed on a new 15-year, fixed-rate mortgage financing in the amount of \$40,000,000, secured by Lansdowne Town Center. The loan matures June 10, 2022, requires equal monthly principal and interest payments of \$230,137, based upon a 5.62% interest rate and 30-year principal amortization, and requires a final payment of \$28,177,000 at maturity.

At December 31, 2006, the Company's outstanding debt totaled \$522,443,000, of which \$487,443,000 was fixed rate mortgage debt and \$35,000,000 was variable rate debt outstanding on the Company's \$150,000,000 unsecured revolving credit facility. Based upon the terms of the facility as of December 31, 2006, the unencumbered properties supported line availability of \$87,000,000, of which \$1,627,000 was issued under a letter of credit and \$35,000,000 was borrowed, leaving \$50,373,000 available for working capital uses. An additional \$63,000,000 could become available for funding working capital and operating property acquisitions as unencumbered properties' internal cash flow grows and operating income is provided by future unencumbered acquisitions.

**Table of Contents**

At June 30, 2007, the scheduled maturities of all debt, including scheduled principal amortization, for years ending December 31, were as follows:

**Debt Maturity Schedule**

*(Dollars in thousands)*

July 1 through December 31, 2007	\$ 7,588
2008	16,015
2009	17,237
2010	18,521
2011	82,138
2012	110,343
Thereafter	268,503
	\$ 520,345

Interest expense and amortization of deferred debt costs for the quarter ended June 30, 2007 and 2006, respectively were as follows:

**Interest Expense and Amortization of Deferred Debt Costs**

<i>(Dollars in thousands)</i>	<b>Quarter ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Interest incurred	\$ 8,811	\$ 8,697	\$ 17,689	\$ 17,203
Amortization of deferred debt costs	278	272	554	540
Capitalized interest	(764)	(897)	(1,624)	(1,652)
	\$ 8,325	\$ 8,072	\$ 16,619	\$ 16,091

**6. Stockholders' Equity and Minority Interests**

The Consolidated Statement of Operations for the three months ended June 30, 2007 and June 30, 2006, includes a charge for minority interests of \$2,151,000 and \$1,851,000, respectively, and \$4,286,000 and \$3,653,000, respectively, for the six months ended June 30, all representing The Saul Organization's limited partnership interest share of net income for each quarter and period.

**7. Related Party Transactions**

Chevy Chase Bank, an affiliate of The Saul Organization, leases space in 17 of the Company's properties. Total rental income from Chevy Chase Bank amounted to \$1,423,000 and \$1,043,000, for the six months ended June 30, 2007 and 2006, respectively.

**Table of Contents**

The Company utilizes Chevy Chase Bank for its various checking and short-term investment accounts. As of June 30, 2007, approximately \$11,458,000 was held in deposit in these accounts.

The Chairman and Chief Executive Officer, the President, the Senior Vice President- General Counsel and the 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 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 profit sharing retirement plan with other entities within The Saul Organization which covers those full-time employees who meet the requirements as specified in the plan. Beginning January 1, 2002, only employer contributions are made to the plan. Each participant who is entitled to be credited with at least one hour of service on or after January 1, 2002, shall be 100% vested in his or her employer contribution account and no portion of such account shall be forfeitable. Employer contributions, at the discretionary amount of up to six percent of the employee's cash compensation, subject to certain limits, were \$156,000 and \$150,000, for the six months ended June 30, 2007 and 2006, respectively. There are no past service costs associated with the plan since it is of the defined-contribution type.

The Company also participates in a multiemployer nonqualified deferred plan with entities in The Saul Organization which covers those full-time employees who meet the requirements as specified in the plan. The plan, which can be modified or discontinued at any time, requires participating employees to defer 2% of their compensation over a specified amount. The Company is required to contribute three times the amount deferred by employees. The Company's contribution totaled \$47,000 and \$44,000, for the six months ended June 30, 2007 and 2006, respectively. All amounts deferred by employees and the Company are fully vested. The cumulative unfunded liability under this plan was \$762,000 and \$709,000 at June 30, 2007 and December 31, 2006, 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 for in the Agreement and depending upon the service, 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 six months ended June 30, 2007 and 2006, which included rental payments for the Company's headquarters lease, totaled \$2,274,000 and \$1,786,000, respectively. The amounts are expensed when billed and are primarily reported as general and administrative expenses in these consolidated financial statements. As of June 30, 2007 and December 31, 2006, accounts payable, accrued expenses and other liabilities included \$260,000 and \$255,000, respectively, representing billings due to The Saul Organization for the Company's share of these ancillary costs and expenses.

**Table of Contents**

The Company's corporate headquarters lease, which commenced in March 2002, is leased by a member of The Saul Organization. The 10-year lease provides for base rent escalated at 3% per year, with payment of a pro-rata share of operating expenses over a base year amount. Pursuant to the above described Agreement, the participants pay an allocation of total rental payments on a percentage proportionate to the number of employees employed by each party. The Company's rent payments for the six months ended June 30, 2007 and 2006 were \$401,000 and \$362,000, respectively. Expenses arising from the lease are included in general and administrative expenses.

On January 12, 2006, the Company agreed to final terms of a contract to purchase a 10.4 acre site in Frederick, Maryland, from a subsidiary of Chevy Chase Bank, a related party, for \$5,000,000. The Company plans to develop this property into a retail center. The purchase price of the property was determined by the average of two independent third party appraisals which were contracted, one on behalf of the Company and one on behalf of Chevy Chase Bank. The parties anticipate closing on the transaction later in 2007.

**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.

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 six months ended June 30, 2007:



**Table of Contents**Stock options issued to officers

	<b>Officers</b>				<b>Subtotal</b>
	05/23/2003	04/26/2004	05/06/2005	04/27/2007	
Grant date	05/23/2003	04/26/2004	05/06/2005	04/27/2007	
Total grant	220,000	122,500	132,500	135,000	610,000
Vested	220,000	91,875	66,250		378,125
Exercised	81,422	25,625	5,625		112,672
Forfeited	7,500	7,500	11,250		26,250
Exercisable at June 30, 2007	131,078	58,750	49,375		239,203
Remaining unexercised	131,078	89,375	115,625	135,000	471,078
Exercise price	\$ 24.91	\$ 25.78	\$ 33.22	\$ 54.17	
Volatility	0.175	0.183	0.207	0.233	
Expected life (years)	7.0	7.0	8.0	6.5	
Assumed yield	7.00%	5.75%	6.37%	4.13%	
Risk-free rate	4.00%	4.05%	4.15%	4.61%	
Total value at grant date	\$ 332,200	\$ 292,775	\$ 413,400	\$ 1,258,848	\$ 2,297,223
Expensed in previous years	292,843	190,208	164,460		647,511
Forfeited options	11,325	17,925	35,100		64,350
Expensed during the six months ended June 30, 2007	28,032	32,118	45,826	52,452	158,428
Future expense		\$ 52,524	\$ 168,014	\$ 1,206,396	\$ 1,426,934

Stock options issued to directors and grand totals

	<b>Directors</b>				<b>Subtotal</b>	<b>Grand Totals</b>
	04/26/2004	05/06/2005	05/01/2006	04/27/2007		
Grant date	04/26/2004	05/06/2005	05/01/2006	04/27/2007		
Total grant	30,000	30,000	30,000	30,000	120,000	<b>730,000</b>
Vested	30,000	30,000	30,000	30,000	120,000	<b>498,125</b>
Exercised	1,200				1,200	<b>113,872</b>
Forfeited						<b>26,250</b>
Exercisable at June 30, 2007	28,800	30,000	30,000	30,000	118,800	<b>358,003</b>
Remaining unexercised	28,800	30,000	30,000	30,000	118,800	<b>589,878</b>
Exercise price	\$ 25.78	\$ 33.22	\$ 40.35	\$ 54.17		
Volatility	0.183	0.198	0.206	0.225		
Expected life (years)	5.0	10.0	9.0	8.0		
Assumed yield	5.75%	6.91%	5.93%	4.39%		
Risk-free rate	3.57%	4.28%	5.11%	4.65%		
Total value at grant date	\$ 66,600	\$ 71,100	\$ 143,400	\$ 285,300	\$ 566,400	<b>\$ 2,863,623</b>
Expensed in previous years	66,600	71,100	143,400		281,100	<b>928,611</b>
Forfeited options						<b>64,350</b>
Expensed during the six months ended June 30, 2007				285,300	285,300	<b>443,728</b>
Future expense						<b>\$ 1,426,934</b>
Weighted average term of future expense (Officer and Director options)						<b>3.5 yrs</b>

**Table of Contents**

The table below summarizes the option activity for the six months ended June 30, 2007:

	Number of Shares	Wtd Avg Exercise Price/sh	Aggregate Intrinsic Value
Outstanding at January 1	430,453	\$ 29.06	
Granted	165,000	54.17	
Exercised	5,575	26.61	\$ 130,931
Expired/Forfeited			
Outstanding June 30	589,878	36.11	6,908,350
Exercisable at June 30	358,003	30.71	5,505,407

The intrinsic value presented in the table above measures the price difference between the options' exercise price and the closing share price quoted by the New York Stock Exchange as of the date of measurement. The date of exercise was the measurement date for shares exercised during the period. At June 30, 2007, the closing share price was \$45.35 and was used for the calculation of aggregate intrinsic value of options outstanding and exercisable at that date. Options having an exercise price in excess of the June 30, 2007 closing price have no intrinsic value. The weighted average remaining contractual life of the Company's exercisable and outstanding options are 7.1 and 7.8 years, respectively.

**9. Commitments and Contingencies**

Neither the Company nor the Current Portfolio Properties are subject to any material litigation, nor, to management's knowledge, is any material litigation currently threatened against the Company, other than routine litigation and administrative proceedings arising in the ordinary course of business. Management believes that these items, individually or in the aggregate, will not have a material adverse impact on the Company or the Current Portfolio Properties.

**Table of Contents****10. Business Segments**

The Company has two reportable business segments: Shopping Centers and Office Properties. The accounting policies for the segments presented below are the same as those described in the summary of significant accounting policies (see Note 2). The Company evaluates performance based upon net operating income for properties in each segment.

	Shopping	Office	Corporate	Consolidated
	Centers	Properties	and Other	Totals
<i>(Dollars in thousands)</i>				
<b>Quarter ended June 30, 2007</b>				
Real estate rental operations:				
Revenue	\$ 27,550	\$ 9,385	\$ 142	\$ 37,077
Expenses	(5,565)	(2,419)		(7,984)
Income from real estate	21,985	6,966	142	29,093
Interest expense & amortization of deferred debt			(8,325)	(8,325)
General and administrative			(3,188)	(3,188)
Subtotal	21,985	6,966	(11,371)	17,580
Depreciation and amortization of deferred leasing costs	(4,413)	(2,090)		(6,503)
Minority interests			(2,151)	(2,151)
Net income	\$ 17,572	\$ 4,876	\$ (13,522)	\$ 8,926
Capital investment	\$ 9,012	\$ 323	\$ 2,857	\$ 12,192
Total assets	\$ 541,963	\$ 128,512	\$ 36,392	\$ 706,867
<b>Quarter ended June 30, 2006</b>				
Real estate rental operations:				
Revenue	\$ 24,852	\$ 8,797	\$ 99	\$ 33,748
Expenses	(4,848)	(2,216)		(7,064)
Income from real estate	20,004	6,581	99	26,684
Interest expense & amortization of deferred debt			(8,072)	(8,072)
General and administrative			(2,564)	(2,564)
Subtotal	20,004	6,581	(10,537)	16,048
Depreciation and amortization of deferred leasing costs	(4,401)	(1,999)		(6,400)
Minority interests			(1,851)	(1,851)
Net income	\$ 15,603	\$ 4,582	\$ (12,388)	\$ 7,797
Capital investment	\$ 25,880	\$ 914	\$ 625	\$ 27,419
Total assets	\$ 516,549	\$ 133,466	\$ 24,614	\$ 674,629

**Table of Contents**

	Shopping	Office	Corporate	Consolidated
	Centers	Properties	and Other	Totals
<i>(Dollars in thousands)</i>				
<b>Six months ended June 30, 2007</b>				
Real estate rental operations:				
Revenue	\$ 54,741	\$ 18,782	\$ 238	\$ 73,761
Expenses	(11,532)	(4,895)		(16,427)
Income from real estate	43,209	13,887	238	57,334
Interest expense & amortization of deferred debt			(16,619)	(16,619)
General and administrative			(5,678)	(5,678)
Subtotal	43,209	13,887	(22,059)	35,037
Depreciation and amortization of deferred leasing costs	(8,839)	(4,112)		(12,951)
Minority interests			(4,286)	(4,286)
Net income	\$ 34,370	\$ 9,775	\$ (26,345)	\$ 17,800
Capital investment	\$ 13,626	\$ 827	\$ 4,277	\$ 18,730
Total assets	\$ 541,963	\$ 128,512	\$ 36,392	\$ 706,867
<b>Six months ended June 30, 2006</b>				
Real estate rental operations:				
Revenue	\$ 49,391	\$ 17,657	\$ 167	\$ 67,215
Expenses	(9,740)	(4,424)		(14,164)
Income from real estate	39,651	13,233	167	53,051
Interest expense & amortization of deferred debt			(16,091)	(16,091)
General and administrative			(5,027)	(5,027)
Subtotal	39,651	13,233	(20,951)	31,933
Depreciation and amortization of deferred leasing costs	(8,828)	(3,948)		(12,776)
Minority interests			(3,653)	(3,653)
Net income	\$ 30,823	\$ 9,285	\$ (24,604)	\$ 15,504
Capital investment	\$ 40,192	\$ 1,068	\$ 1,053	\$ 42,313
Total assets	\$ 516,549	\$ 133,466	\$ 24,614	\$ 674,629

**11. Subsequent Events**

On July 19, 2007, the Company acquired the 88,000 square foot Orchard Park Shopping Center located in the Dunwoody community of metropolitan Atlanta, Georgia. The center is the Company's third neighborhood shopping center in the Atlanta area, and was purchased for \$17,000,000. Orchard Park was constructed in 1981, is 98.7% leased and is anchored by a 55,000 square foot Kroger supermarket.

---

**Table of Contents**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This section should be read in conjunction with the consolidated financial statements of the Company and the accompanying notes in Item 1. Financial Statements of this report and the more detailed information contained in our Form 10-K for the year ended December 31, 2006. Historical results and percentage relationships set forth in Item 1 and this section should not be taken as indicative of future operations of the Company. Capitalized terms used but not otherwise defined in this section, have the meanings given to them in Item 1 of this Form 10-Q.

**Forward-Looking Statements**

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are generally characterized by terms such as believe, expect and may.

Although the Company believes that the expectations reflected in such forward-looking statements are based upon reasonable assumptions, the Company's actual results could differ materially from those given in the forward-looking statements as a result of changes in factors which include among others, the following:

risks that the Company's tenants will not pay rent;

risks related to the Company's reliance on shopping center anchor tenants and other significant tenants;

risks related to the Company's substantial relationships with members of The Saul Organization;

risks of financing, such as increases in interest rates, restrictions imposed by the Company's debt, the Company's ability to meet existing financial covenants and the Company's ability to consummate planned and additional financings on acceptable terms;

risks related to the Company's development activities;

risks that the Company's growth will be limited if the Company cannot obtain additional capital;

risks that planned and additional acquisitions or redevelopments may not be consummated, or if they are consummated, that they will not perform as expected;

risks generally incident to the ownership of real property, including adverse changes in economic conditions, changes in the investment climate for real estate, changes in real estate taxes and other operating expenses, adverse changes in governmental rules and fiscal policies, the relative illiquidity of real estate and environmental risks;

risks related to the Company's status as a REIT for federal income tax purposes, such as the existence of complex regulations relating to the Company's status as a REIT, the effect of future changes in REIT requirements as a result of new legislation and the adverse consequences of the failure to qualify as a REIT; and

## Table of Contents

such other risks as described in Item 1A of our Form 10-K for the year ended December 31, 2006

### General

The following discussion is based primarily on the consolidated financial statements of the Company, as of June 30, 2007 and for the three and six month periods ended June 30, 2007.

### Critical Accounting Policies

The Company's accounting policies are in conformity with U.S. generally accepted accounting principles ( GAAP ). The preparation of financial statements in conformity with GAAP requires management to use judgment in the application of accounting policies, including making estimates and assumptions. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the Company's financial statements and the reported amounts of revenue and expenses during the reporting periods. If judgment or interpretation of the facts and circumstances relating to various transactions had been different, it is possible that different accounting policies would have been applied resulting in a different presentation of the financial statements. Below is a discussion of accounting policies which the Company considers critical in that they may require judgment in their application or require estimates about matters which are inherently uncertain. Additional discussion of accounting policies which the Company considers significant, including further discussion of the critical accounting policies described below, can be found in the notes to the Consolidated Financial Statements.

#### *Real Estate Investments*

Real estate investment properties are stated at historic cost basis less depreciation. Management believes that these assets have generally appreciated in value and, accordingly, the aggregate current value exceeds their aggregate net book value and also exceeds the value of the Company's liabilities as reported in these financial statements. Because these financial statements are prepared in conformity with GAAP, they do not report the current value of the Company's real estate assets. The purchase price of real estate assets acquired is allocated between land, building and in-place acquired leases based on the relative fair values of the components at the date of acquisition. Buildings are depreciated on a straight-line basis over their estimated useful lives of 35 to 50 years. Intangibles associated with acquired in-place leases are amortized over the remaining base lease terms.

If there is an event or change in circumstance that indicates an impairment in the value of a real estate investment property, the Company assesses an impairment in value by making a comparison of the current and projected operating cash flows of the property over its remaining useful life, on an undiscounted basis, to the carrying amount or projected carrying amount of that property. If such carrying amount is greater than the estimated projected cash flows, the Company would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its estimated fair market value.

## **Table of Contents**

When incurred, the Company capitalizes the cost of improvements that extend the useful life of property and equipment and all repair and maintenance expenditures are expensed. In addition, we capitalize leasehold improvements when certain criteria are met, including when we supervise construction and will own the improvement.

Interest, real estate taxes and other carrying costs are capitalized on projects under construction. Once construction is substantially complete and the assets are placed in service, rental income, direct operating expenses, and depreciation associated with such properties are included in current operations.

In the initial rental operations of development projects, 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. Leasehold improvements are amortized over the lives of the related leases using the straight-line method.

### *Deferred Leasing Costs*

Certain initial direct costs incurred by the Company in negotiating and consummating successful leases are capitalized and amortized over the initial base term of the leases. Deferred leasing costs consist of commissions paid to third party leasing agents as well as internal direct costs such as employee compensation and payroll related fringe benefits directly related to time spent performing leasing related activities. Such activities include evaluating prospective tenants' financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating lease terms, preparing lease documents and closing transactions.

### *Revenue Recognition*

Rental and interest income is accrued as earned except when doubt exists as to collectibility, 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 throughout the initial term of the lease. 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, known as percentage rent, is accrued when a tenant reports sales that exceed a specified breakpoint.

### *Allowance for Doubtful Accounts - Current and Deferred Receivables*

Accounts receivable primarily represent amounts accrued and unpaid from tenants in accordance with the terms of the respective leases, subject to the Company's revenue recognition policy. 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. In addition to rents due currently, accounts receivable include amounts representing minimum

**Table of Contents**

rental income accrued on a straight-line basis to be paid by tenants over the remaining term of their respective leases. Reserves are established with a charge to income for tenants whose rent payment history or financial condition casts doubt upon the tenant's ability to perform under its lease obligations.

*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. While the resolution of these matters cannot be predicted with certainty, the Company believes the final outcome of such matters will not have a material adverse effect on the financial position or the results of operations. Once it has been determined that a loss is probable to occur, the estimated amount of the loss is recorded in the financial statements. Both the amount of the loss and the point at which its occurrence is considered probable can be difficult to determine.

**Results of Operations****Quarter ended June 30, 2007 compared to quarter ended June 30, 2006****Revenue**

<i>(Dollars in thousands)</i>	Quarters ended June 30,		2007 to 2006 Change	
	2007	2006	\$	%
Base rent	\$ 29,531	\$ 27,190	\$ 2,341	8.6%
Expense recoveries	6,282	5,407	875	16.2%
Percentage rent	312	272	40	14.7%
Other	952	879	73	8.3%
<b>Total revenue</b>	<b>\$ 37,077</b>	<b>\$ 33,748</b>	<b>\$ 3,329</b>	<b>9.9%</b>

Total revenue increased 9.9% in the quarter ended June 30, 2007 ( 2007 Quarter ) compared to the corresponding prior year's quarter ( 2006 Quarter ). The revenue increase for the 2007 Quarter resulted primarily from the operations of two newly developed properties and an acquisition property whose operating results are included in the current quarter but not fully in the corresponding prior year's results. The development properties (Broadlands Village III and Lansdowne Town Center) and the acquisition property (Hunt Club Corners) together defined as the Development and Acquisition Properties, contributed \$1,718,000 of the revenue increase. Improved operating results at the remaining properties contributed \$1,567,000 of the quarter over quarter revenue growth. Increased interest income provided the balance of the 2007 quarter's revenue increase (\$44,000). A discussion of the components of revenue follows.

*Base rent.* The increase in base rent for the 2007 Quarter versus the 2006 Quarter was primarily attributable to leases in effect at the Development and Acquisition Properties (63.5% or



**Table of Contents**

approximately \$1,487,000). The leasing of space at Van Ness Square, Washington Square, Beacon Center, Thruway and Ashburn Village substantially accounted for the balance of the increase (34.4% or approximately \$806,000).

*Expense recoveries.* Expense recoveries represent a portion of property operating expenses billable to tenants, including common area maintenance, real estate taxes and other recoverable costs. The majority of the increase in expense recovery income resulted from billings to tenants for their share of increased real estate tax expense and property operating expenses throughout the core operating properties (75.0% or approximately \$656,000). The Development and Acquisition Properties contributed the balance of the increase (25.0% or approximately \$219,000).

*Percentage rent.* Percentage rent is rental revenue calculated on the portion of a tenant's sales revenue that exceeds a specified breakpoint. Percentage rent for the 2007 Quarter increased due to timing differences in the submission of sales reports used to calculate percentage rent by a tenant at Beacon Center (62.5% or approximately \$25,000). Net increases in percentage rent at several other properties contributed toward the overall percentage rent increase.

*Other revenue.* Other revenue consists primarily of parking revenue at three of the Office Properties, temporary lease rental income, payments associated with early termination of leases and interest income from the investment of cash balances. Other revenue for the 2007 Quarter increased due to increased interest income from short-term investments (60.3% or approximately \$44,000). Increased lease termination payments received from former tenants at Lumberton and The Glen, offset in part by a payment received in the prior year period by a tenant at Van Ness Square contributed the balance of the increase in other revenue.

**Operating Expenses**

<i>(Dollars in thousands)</i>	Quarters ended June 30,		2007 to 2006 Change	
	2007	2006	\$	%
Property operating expenses	\$ 4,343	\$ 3,963	\$ 380	9.6%
Provision for credit losses	103	107	(4)	-3.7%
Real estate taxes	3,538	2,994	544	18.2%
Interest expense and amortization of deferred debt	8,325	8,072	253	3.1%
Depreciation and amortization of leasing costs	6,503	6,400	103	1.6%
General and administrative	3,188	2,564	624	24.3%
<b>Total operating expenses</b>	<b>\$ 26,000</b>	<b>\$ 24,100</b>	<b>\$ 1,900</b>	<b>7.9%</b>

**Table of Contents**

Increases in operating expenses resulted primarily from operating and financing the Development and Acquisition Properties and to a lesser extent, expense increases to operate the balance of Company's Current Portfolio Properties.

*Property operating expenses.* Property operating expenses consist of repairs and maintenance, utilities, payroll, insurance and other property related expenses. The most significant cause of the property operating expense increase was increased property operating expenses for the Development and Acquisition Properties (67.6% or approximately \$257,000). The balance of the increase represents a 3.1% increase in property operating expenses for the remainder of the Company's Current Portfolio Properties.

*Provision for credit losses.* The provision for credit losses represents the Company's estimation that amounts previously included in income and owed by tenants may not be collectible. The amount reported in each quarter represents only three tenths of one percent (0.3%) of total revenue for each quarter, an indication of the relative credit quality of the Company's tenants.

*Real estate taxes.* The increase in real estate taxes for the 2007 Quarter versus the 2006 Quarter was largely impacted by increased assessments at the Company's core properties, primarily 601 Pennsylvania Avenue, White Oak, Countryside, Ashburn Village and The Glen (60.5% or approximately \$329,000). The Development and Acquisition Properties also contributed toward the increase (16.4% or approximately \$89,000). The balance of the increase represents an approximately 5.4% quarter over quarter increase in real estate taxes for the remainder of the Company's Current Portfolio Properties.

*Interest and amortization of deferred debt.* Interest expense increased in the 2007 Quarter versus the 2006 Quarter due to increased borrowing for the Development and Acquisition Properties. The increase in average outstanding borrowings of approximately \$9,700,000 resulted from financing the Development and Acquisition Properties and construction in progress (approximately \$166,000 increase in interest expense). Interest was capitalized as a cost of construction and development projects during the 2007 and 2006 Quarters in the amounts of \$764,000 and \$897,000, respectively (approximately \$133,000 increase in interest expense). Deferred debt cost amortization was \$278,000 and \$272,000, for the 2007 and 2006 Quarters, respectively (approximately \$6,000 increase).

*Depreciation and amortization of deferred leasing costs.* The increase in depreciation and amortization of deferred leasing costs resulted primarily from the Development and Acquisition Properties placed in service during the preceding twelve months.

*General and administrative.* General and administrative expenses consist of payroll, administrative and other overhead expenses. General and administrative expenses increased for the 2007 Quarter compared to the 2006 Quarter, primarily due to increased payroll expenses (approximately \$186,000 or 29.8%), non-cash option expenses (approximately \$180,000 or 28.8%) and state income taxes (approximately \$103,000 or 16.5%).

**Table of Contents****Six months ended June 30, 2007 compared to the six months ended June 30, 2006****Revenue**

<i>(Dollars in thousands)</i>	Six months ended June 30,		2007 to 2006 Change	
	2007	2006	\$	%
Base rent	\$ 58,552	\$ 54,090	\$ 4,462	8.2%
Expense recoveries	12,880	10,920	1,960	17.9%
Percentage rent	514	598	(84)	-14.0%
Other	1,815	1,607	208	12.9%
<b>Total revenue</b>	<b>\$ 73,761</b>	<b>\$ 67,215</b>	<b>\$ 6,546</b>	<b>9.7%</b>

Total revenue increased 9.7% in the six month period ended June 30, 2007 ( 2007 Period ) compared to the corresponding prior year's period ( 2006 Period ). The revenue increase for the 2007 Period resulted primarily from the operations of two newly developed properties and two acquisition properties whose operating results are included in the current period but not fully in the corresponding prior year's results. The development properties (Broadlands Village III and Lansdowne Town Center) and the acquisition properties (Smallwood Village Center and Hunt Club Corners) together defined as the Development and Acquisition Properties, contributed \$3,139,000 of the revenue increase. Improved operating results at the remaining properties contributed \$3,335,000 of the period over period revenue growth. Increased interest income provided the balance of the 2007 period's revenue increase (\$72,000). A discussion of the components of revenue follows.

*Base rent.* The increase in base rent for the 2007 Period versus the 2006 Period was primarily attributable to leases in effect at the Development and Acquisition Properties (60.0% or approximately \$2,675,000). The leasing of space at Washington Square, Beacon Center, Van Ness Square, Thruway, Ashburn Village, Ravenwood and Olde Forte Village substantially accounted for the balance of the increase (33.2% or approximately \$1,482,000).

*Expense recoveries.* Expense recoveries represent a portion of property operating expenses billable to tenants, including common area maintenance, real estate taxes and other recoverable costs. The majority of the increase in expense recovery income resulted from billings to tenants for their share of increased property operating expenses, particularly snow removal costs, (40.3% or approximately \$790,000) and increased real estate tax expense (37.1% or approximately \$728,000) throughout the core operating properties. The Development and Acquisition Properties contributed the balance of the increase (22.6% or approximately \$442,000).

*Percentage rent.* Percentage rent is rental revenue calculated on the portion of a tenant's sales revenue that exceeds a specified breakpoint. Percentage rent for the 2007 Period decreased due to a decline in sales reported by a tenant at two of the Shopping Centers of approximately \$119,000. The decrease was partially offset by net increases in percentage rent at several other properties.

**Table of Contents**

*Other revenue.* Other revenue consists primarily of parking revenue at three of the Office Properties, temporary lease rental income, payments associated with early termination of leases and interest income from the investment of cash balances. Other revenue increased due to increased interest income from short-term investments (34.6% or approximately \$72,000), increased parking revenue in the office portfolio (26.0% or approximately \$54,000) and increased lease termination fees (20.7% or approximately \$43,000).

**Operating Expenses**

<i>(Dollars in thousands)</i>	Six months ended June 30,		2007 to 2006 Change	
	2007	2006	\$	%
Property operating expenses	\$ 9,148	\$ 7,931	\$ 1,217	15.3%
Provision for credit losses	215	187	28	15.0%
Real estate taxes	7,064	6,046	1,018	16.8%
Interest expense and amortization of deferred debt	16,619	16,091	528	3.3%
Depreciation and amortization of leasing costs	12,951	12,776	175	1.4%
General and administrative	5,678	5,027	651	13.0%
<b>Total operating expenses</b>	<b>\$ 51,675</b>	<b>\$ 48,058</b>	<b>\$ 3,617</b>	<b>7.5%</b>

Increases in operating expenses resulted primarily from operating and financing the Development and Acquisition Properties and to a lesser extent, expense increases to operate the balance of Company's Current Portfolio Properties.

*Property operating expenses.* Property operating expenses consist of repairs and maintenance, utilities, payroll, insurance and other property related expenses. The property operating expense increase was caused by the addition of property operating expenses for the Development and Acquisition Properties (50.9% or approximately \$619,000) and increased snow removal costs due to severe winter storms experienced during the 2007 Period (38.0% or approximately \$463,000). The balance of the increase represents a 1.8% increase in property operating expenses for the remainder of the Company's Current Portfolio Properties.

*Provision for credit losses.* The provision for credit losses represents the Company's estimation that amounts previously included in income and owed by tenants may not be collectible. The provision for credit losses represents only three tenths of one percent (0.3%) of total revenue for the 2007 and 2006 Periods, an indication of the relative credit quality of the Company's tenants.

*Real estate taxes.* The increase in real estate taxes for the 2007 Period versus the 2006 Period was largely impacted by increased assessments at the Company's core properties, primarily 601 Pennsylvania Avenue, White Oak, Countryside, Ashburn Village and The Glen (52.7% or approximately \$536,000). The Development and Acquisition Properties also contributed toward

**Table of Contents**

the increase (20.1% or approximately \$205,000). The balance of the increase represents an approximately 6.1% period over period increase in real estate taxes for the remainder of the Company's Current Portfolio Properties.

*Interest and amortization of deferred debt.* Interest expense increased in the 2007 Period versus the 2006 Period due to increased borrowing for the Development and Acquisition Properties. The increase in average outstanding borrowings of approximately \$15,900,000 (\$13,300,000 variable rate line of credit borrowing and \$2,600,000 fixed rate mortgage loan balances) resulted from financing the Development and Acquisition Properties and construction in progress (approximately \$544,000 increase in interest expense). Interest was capitalized as a cost of construction and development projects during the 2007 and 2006 Periods in the amounts of \$1,624,000 and \$1,652,000, respectively (approximately \$28,000 increase in interest expense). Deferred debt cost amortization was \$554,000 and \$540,000, for the 2007 and 2006 Periods, respectively (approximately \$14,000 increase).

*Depreciation and amortization of deferred leasing costs.* The increase in depreciation and amortization of deferred leasing costs resulted primarily from the Development and Acquisition Properties placed in service during the preceding twelve months.

*General and administrative.* General and administrative expenses consist of payroll, administrative and other overhead expenses. General and administrative expenses increased for the 2007 Period compared to the 2006 Period, primarily due to increased payroll expenses (approximately \$291,000 or 44.7%), non-cash option expenses (approximately \$172,000 or 26.4%) and data processing expenses (approximately \$84,000 or 12.9%).

**Liquidity and Capital Resources**

Cash and cash equivalents were \$11,535,000 and \$3,045,000 at June 30, 2007 and 2006, respectively. The Company's cash flow is affected by its operating, investing and financing activities, as described below.

<i>(Dollars in thousands)</i>	<b>Six Months Ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
Cash provided by operating activities	\$ 36,815	\$ 32,956
Cash used by investing activities	(18,730)	(42,313)
Cash (used) provided by financing activities	(14,611)	4,395
Increase (decrease) in cash	\$ 3,474	\$ (4,962)

**Table of Contents**

*Operating Activities*

Cash provided by operating activities represents cash received primarily from rental income, plus other income, less property operating expenses, normal recurring general and administrative expenses and interest payments on debt outstanding.

*Investing Activities*

Cash used in investing activities includes property acquisitions, developments, redevelopments, tenant improvements and other property capital expenditures. Investing activities for 2007 primarily reflect the development and construction costs of new properties (Lansdowne Towne Center, Ashburn Village V, Ashland Square and Clarendon Center), and the construction costs of redevelopments (Seven Corners). Investing activities for 2006 primarily reflect the acquisition of a property (Smallwood Village Center), the development and construction costs of new properties (Lansdowne Towne Center, Broadlands Village III, Ashland Square and Clarendon Center), and the construction costs of redevelopments (Ravenwood). Tenant improvement and property capital expenditures totaled \$3,863,000 and \$8,392,000, for the 2007 and 2006 periods, respectively.

*Financing Activities*

Cash used by financing activities for the period ended June 30, 2007 primarily reflects:

the repayment of mortgage note payable borrowings totaling \$7,098,000;

repayments of \$35,000,000 on the revolving credit facility;

distributions to common stockholders during the period totaling \$14,961,000;

distributions to holders of convertible limited partnership units in the Operating Partnership during the period totaling \$4,658,000;

distributions made to preferred stockholders during the period totaling \$4,000,000; and

payments of \$493,000 for financing costs of mortgage notes payable;  
which was partially offset by:

Proceeds of \$40,000,000 received from mortgage notes payable originated during the period; and

Proceeds of \$11,599,000 received from the issuance of common stock from the exercise of employee stock options and shares issued under the dividend reinvestment program.

**Table of Contents**

Cash provided by financing activities for the period ended June 30, 2006 primarily reflects:

Proceeds of \$20,000,000 received from advances provided by the revolving credit facility during the period;

Proceeds of \$10,500,000 received from mortgage notes payable originated during the period;

Proceeds of \$4,126,000 received from the issuance of common stock from the exercise of employee stock options and shares issued under the dividend reinvestment program; and

Proceeds of \$4,001,000 received from the issuance of convertible limited partnership interests in the Operating Partnership; which was substantially offset by:

the repayment of borrowings on mortgage notes payable totaling \$6,523,000;

repayments of \$4,500,000 on the revolving credit facility;

distributions to common stockholders during the period totaling \$14,215,000;

distributions to holders of convertible limited partnership units in the Operating Partnership during the period totaling \$4,484,000;

distributions made to preferred stockholders during the period totaling \$4,000,000; and

payment of \$510,000 for financing costs of new mortgage loans.

*Liquidity Requirements*

Short-term liquidity requirements consist primarily of normal recurring operating expenses and capital expenditures, debt service requirements (including debt service relating to additional and replacement debt), distributions to common and preferred stockholders, distributions to unit holders and amounts required for expansion and renovation of the Current Portfolio Properties and selective acquisition and development of additional properties. In order to qualify as a REIT for federal income tax purposes, the Company must distribute to its stockholders at least 90% of its real estate investment trust taxable income, as defined in the Internal Revenue Code. The Company expects to meet these short-term liquidity requirements (other than amounts required for additional property acquisitions and developments) through cash provided from operations and its existing line of credit. The Company anticipates that any additional property acquisitions and developments in the next 12 months will be funded with future long-term secured and unsecured debt and the public or private issuance of common or preferred equity or units, each of which may be initially funded with our existing line of credit.

Long-term liquidity requirements consisted primarily of obligations under our long-term debt and dividends paid to our preferred shareholders. The Company anticipates that long-term

**Table of Contents**

liquidity requirements will also include amounts required for property acquisitions and developments. The Company expects to meet long-term liquidity requirements through cash provided from operations, long-term secured and unsecured borrowings, private or public offerings of debt or equity securities and proceeds from the sales of properties. Borrowings may be at the Saul Centers, Operating Partnership or Subsidiary Partnership level, and securities offerings may include (subject to certain limitations) the issuance of additional limited partnership interests in the Operating Partnership which can be converted into shares of Saul Centers common stock. The availability and terms of any such financing will depend upon market and other conditions.

As of June 30, 2007, the scheduled maturities, including scheduled principal amortization, of all debt for years ended December 31, are as follows:

**Debt Maturity Schedule**

*(Dollars in thousands)*

July 1 through December 31, 2007	\$ 7,588
2008	16,015
2009	17,237
2010	18,521
2011	82,138
2012	110,343
Thereafter	268,503
	\$ 520,345

Management believes that the Company's capital resources, which at June 30, 2007 included cash balances of approximately \$11.5 million and borrowing availability of \$87.9 million on its revolving line of credit, will be sufficient to meet its liquidity needs for the foreseeable future. The Company may also borrow an additional \$60.0 million on its revolving credit line for funding working capital and operating property acquisitions as unencumbered properties' internal cash flow grows and operating income is provided by future unencumbered acquisitions.

***Dividend Reinvestments***

In December 1995, the Company established a Dividend Reinvestment and Stock Purchase Plan (the "Plan") to allow its common stockholders and holders of limited partnership interests an opportunity to buy additional shares of common stock by reinvesting all or a portion of their dividends or distributions. The Plan provides for investing in newly issued shares of common stock at a 3% discount from market price without payment of any brokerage commissions, service charges or other expenses. All expenses of the Plan are paid by the Company. The Company issued 217,312 and 79,211 shares under the Plan at a weighted average discounted price of \$51.92 and \$37.60 per share, during the six month periods ended June 30,



---

**Table of Contents**

2007 and 2006, respectively. The Company also credited 3,406 and 4,243 shares to directors pursuant to the reinvestment of dividends specified by the Directors' Deferred Compensation Plan at a weighted average discounted price of \$51.91 and \$37.70 per share, during the six month periods ended June 30, 2007 and 2006, respectively.

Additionally, the Operating Partnership issued 106,157 limited partnership units under a dividend reinvestment plan mirroring the Plan at a weighted average discounted price of \$37.69 per share during the six month period ended June 30, 2006. No units were issued during the six months ended June 30, 2007.

**Capital Strategy and Financing Activity**

As a general policy, the Company intends to maintain a ratio of its total debt to total asset value of 50% or less and to actively manage the Company's leverage and debt expense on an ongoing basis in order to maintain prudent coverage of fixed charges. Asset value is the aggregate fair market value of the Current Portfolio Properties and any subsequently acquired properties as reasonably determined by management by reference to the properties' aggregate cash flow. Given the Company's current debt level, it is management's belief that the ratio of the Company's debt to total asset value was below 50% as of June 30, 2007.

The organizational documents of the Company do not limit the absolute amount or percentage of indebtedness that it may incur. The Board of Directors may, from time to time, reevaluate the Company's debt capitalization policy in light of current economic conditions, relative costs of capital, market values of the Company property portfolio, opportunities for acquisition, development or expansion, and such other factors as the Board of Directors then deems relevant. The Board of Directors may modify the Company's debt capitalization policy based on such a reevaluation without shareholder approval and consequently, may increase or decrease the Company's debt to total asset ratio above or below 50% or may waive the policy for certain periods of time. The Company selectively continues to refinance or renegotiate the terms of its outstanding debt in order to achieve longer maturities, and obtain generally more favorable loan terms, whenever management determines the financing environment is favorable.

The Company maintains a \$150 million unsecured revolving credit facility. The facility is intended to provide working capital and funds for acquisitions, certain developments and redevelopments. The credit facility has a three-year term expiring January 27, 2008 and provides for an additional one-year extension at the Company's option, subject to the Company's satisfaction of certain conditions. Until January 27, 2007, certain or all of the lenders may, upon request by the Company and payment of certain fees, increase the revolving credit facility line by up to \$50,000,000. Letters of credit may be issued under the revolving credit facility. The facility requires monthly interest payments, if applicable, at a rate of LIBOR plus a spread of 1.40% to 1.625% (determined by certain leverage tests) or upon the bank's reference rate at the Company's option. As of June 30, 2007, no borrowing were outstanding under the facility. The facility requires the Company and its subsidiaries to maintain certain financial covenants. As of June 30, 2007, the material covenants required the Company, on a consolidated basis, to:

limit the amount of debt so as to maintain a gross asset value, as defined in the loan agreement, in excess of liabilities of at least \$400 million;

**Table of Contents**

limit the amount of debt as a percentage of gross asset value, as defined in the loan agreement, to less than 60% (leverage ratio);

limit the amount of debt so that interest coverage will exceed 2.1 to 1 on a trailing four quarter basis; and

limit the amount of debt so that interest, scheduled principal amortization and preferred dividend coverage exceeds 1.55 to 1.

As of June 30, 2007, the Company was in compliance with all such covenants.

On May 30, 2007, the Company closed on a new 15-year, fixed-rate mortgage financing in the amount of \$40,000,000, secured by Lansdowne Town Center. The loan matures June 10, 2022, requires equal monthly principal and interest payments of \$230,137, based upon a 5.62% interest rate and 30-year principal amortization, and requires a final payment of \$28,177,000 at maturity.

**Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements that are reasonably likely to have a current or future material effect on the Company's financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.

**Table of Contents****Funds From Operations**

For the quarter ended June 30, 2007, the Company reported Funds From Operations (FFO)<sup>(1)</sup> available to common shareholders of \$15,580,000, representing a 10.9% increase over the comparative 2006 Period's FFO available to common shareholders. For the six month period ended June 30, 2007, the Company reported FFO available to common shareholders of \$31,037,000, representing an 11.1% increase over the comparative 2006 Period's FFO available to common shareholders. The following table presents a reconciliation from net income to FFO available to common stockholders for the periods indicated:

**Funds From Operations Reconciliation**

<i>(Amounts in thousands)</i>	<b>Quarter ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net income	\$ 8,926	\$ 7,797	\$ 17,800	\$ 15,504
Add:				
Depreciation & amortization of real property	6,503	6,400	12,951	12,776
Minority interests	2,151	1,851	4,286	3,653
<b>FFO</b>	<b>17,580</b>	<b>16,048</b>	<b>35,037</b>	<b>31,933</b>
Subtract:				
Preferred stock dividends	(2,000)	(2,000)	(4,000)	(4,000)
<b>FFO available to common stockholders</b>	<b>\$ 15,580</b>	<b>\$ 14,048</b>	<b>\$ 31,037</b>	<b>\$ 27,933</b>
<b>Average shares &amp; units used to compute FFO per share</b>	<b>23,124</b>	<b>22,525</b>	<b>23,079</b>	<b>22,468</b>

- (1) The National Association of Real Estate Investment Trusts (NAREIT) developed FFO as a relative non-GAAP financial measure of performance of an equity REIT in order to recognize that income-producing real estate historically has not depreciated on the basis determined under GAAP. FFO is defined by NAREIT as net income, computed in accordance with GAAP, plus minority interests, extraordinary items and real estate depreciation and amortization, excluding gains or losses from property sales. FFO does not represent cash generated from operating activities in accordance with GAAP and is not necessarily indicative of cash available to fund cash needs, which is disclosed in the Company's Consolidated Statements of Cash Flows for the applicable periods. There are no material legal or functional restrictions on the use of FFO. FFO should not be considered as an alternative to net income, its most directly comparable GAAP measure, as an indicator of the Company's operating performance, or as an alternative to cash flows as a measure of liquidity. Management considers FFO a meaningful supplemental measure of operating performance because it primarily excludes the assumption that the value of the real estate assets diminishes predictably over time (i.e. depreciation), which is contrary to what we believe occurs with our assets, and because industry analysts have accepted it as a performance measure. FFO may not be comparable to similarly titled measures employed by other REITs.

**Acquisitions, Redevelopments and Renovations**

Management anticipates that during the coming year the Company may: i) redevelop certain of the Current Portfolio Properties, ii) develop additional freestanding outparcels or expansions within certain of the Shopping Centers, iii) acquire existing neighborhood and community shopping centers and/or office properties, and iv) develop new shopping center or office sites. Acquisition and development of properties are undertaken only after careful analysis

## **Table of Contents**

and review, and management's determination that such properties are expected to provide long-term earnings and cash flow growth. During the coming year, any developments, expansions or acquisitions are expected to be funded with bank borrowings from the Company's credit line, construction financing, proceeds from the operation of the Company's dividend reinvestment plan or other external capital resources available to the Company.

The Company has been selectively involved in acquisition, development, redevelopment and renovation activities. It continues to evaluate the acquisition of land parcels for retail and office development and acquisitions of operating properties for opportunities to enhance operating income and cash flow growth. The Company also continues to take advantage of redevelopment, renovation and expansion opportunities within the portfolio, as demonstrated by its recent activities at Broadlands Village, Ravenwood and Ashburn Village. The following describes the acquisition, development, redevelopment and renovation activities of the Company in 2005, 2006 and the six months ended June 30, 2007.

### *Broadlands Village*

The Company purchased 24 acres of undeveloped land in the Broadlands section of the Dulles Technology Corridor of Loudoun County, Virginia in April 2002. Broadlands is a 1,500 acre planned community consisting of 3,500 residences, approximately half of which are constructed and currently occupied. In October 2003, the Company completed construction of the first phase of the Broadlands Village shopping center. The 58,000 square foot Safeway supermarket opened in October 2003 with a pad building and many in-line small shops also opening in the fourth quarter of 2003. Construction of a 30,000 square foot second phase was substantially completed in 2004. The Company's total development costs of both phases, including the land acquisition, were approximately \$22 million. The center was 100% leased at June 30, 2007. During the second quarter of 2006, the Company substantially completed construction of a third phase of this development, totaling approximately 22,000 square feet of shop space and two pad site locations. Development costs for this phase totaled approximately \$7.5 million. All of the new space was leased and all tenants were in occupancy by December 31, 2006.

### *Ashland Square*

On December 15, 2004, the Company acquired a 19.3 acre parcel of land in Dumfries, Prince William County, Virginia for a purchase price of \$6.3 million. The Company has plans to develop the parcel into a grocery-anchored neighborhood shopping center. The Company received site plan approval from Prince William County during the third quarter of 2006 to develop approximately 125,000 square feet of retail space. Approvals for an additional 35,000 square feet of commercial space are expected to be received in 2007. During the third quarter of 2006, the Company commenced site work consisting primarily of clearing, grading and site utility construction. A lease has been executed with Chevy Chase Bank for a branch to be built on a pad site. The bank branch is under construction, with completion anticipated later this year. The balance of the center is being marketed to grocers and other retail businesses, with a development timetable yet to be finalized.

### *New Market*

On March 3, 2005, the Company acquired a 7.1 acre parcel of land located in New Market, Maryland for a purchase price of \$500,000. On September 8, 2005, the Company acquired a 28.4 acre contiguous parcel for a purchase price of \$1.5 million. Together, these

## **Table of Contents**

parcels will accommodate a neighborhood shopping center development in excess of 120,000 square feet of leasable space. The Company has contracted to purchase one additional parcel with the intent to assemble additional acreage for further retail development near this I-70 interchange, east of Frederick, Maryland.

### *Lansdowne Town Center*

During the first quarter of 2005, the Company received approval of a zoning submission to Loudoun County which allowed the development of a neighborhood shopping center named Lansdowne Town Center, within the Lansdowne Community in northern Virginia. On March 29, 2005, the Company finalized the acquisition of an additional 4.5 acres of land to bring the total acreage of the development parcel to 23.4 acres (including the 18.9 acres acquired in 2002). The additional purchase price was approximately \$1.0 million. In late 2006, the Company substantially completed construction of an approximately 188,000 square foot retail center. A lease was executed with Harris Teeter for a 55,000 square foot grocery store, which opened in November 2006. Project costs, upon completion of final tenant improvements, are expected to total approximately \$41.5 million. The project was 91% leased as of June 30, 2007 and 83% of the space was in operation at that time (approximately 156,000 square feet of retail and office space). Substantially all of the retail space is in operation, while the second floor office space is expected to be substantially operational by the end of 2007 (38,000 square feet).

### *Smallwood Village Center*

On January 27, 2006, the Company acquired the 198,000 square foot Smallwood Village Center, located on 25 acres within the St. Charles planned community of Waldorf, Maryland, a suburb of metropolitan Washington, DC, through a wholly-owned subsidiary of its operating partnership. The center was 78% leased at June 30, 2007 and was acquired for a purchase price of \$17.5 million subject to the assumption of an \$11.3 million mortgage loan. The Company is in the process of obtaining permits for a capital improvement project to improve access to the center, reconfigure portions of the center and upgrade the center's façade. A construction timetable has yet to be established.

### *Ravenwood*

In June 2006, the Company substantially completed construction of a 7,380 square foot shop space expansion to the Giant anchored Ravenwood shopping center, located in Towson, Maryland. All of the new space is leased and all of the tenants were in occupancy at June 30, 2007. Development costs totaled approximately \$2.2 million.

### *Lexington Center*

On September 29, 2005, the Company announced the resolution of a land use dispute at Lexington Mall, allowing increased flexibility in future development rights for its property. The Company and the land owner of the adjacent 16 acre site, have resolved a dispute arising from a reciprocal easement agreement governing land use between the two owners. The parties have now executed a new land use agreement which grants each other the flexibility to improve its property. The Company also reached an agreement with Dillard's to terminate its lease, without consideration exchanged by either party. The Dillard's store closed during October 2005. The departure of Dillard's now leaves the mall vacant and combined with the new land use agreement, expands potential redevelopment options. The Company has engaged land planners and architects to prepare conceptual designs for the shopping center's development and is marketing the site to prospective retailers.

**Table of Contents**

*Hunt Club Corners*

On June 1, 2006, the Company completed the acquisition of the 101,500 square foot Publix-anchored Hunt Club Corners shopping center located in Apopka, Florida (metropolitan Orlando). The center was 100% leased at June 30, 2007 and was acquired for a purchase price of \$11.1 million.

*Ashburn Village-Phase V*

The Company completed construction during the fourth quarter of 2006 of a 10,000 square foot shop space expansion to the Ashburn Village shopping center located in Loudoun County, Virginia. The space was 100% leased and operating at June 30, 2007. Development costs totaled approximately \$2.2 million.

*Clarendon Center*

The Company owns an assemblage of land parcels (including its Clarendon and Clarendon Station operating properties) totaling approximately 1.5 acres adjacent to the Clarendon Metro Station in Arlington, Virginia. In June 2006, the Company obtained zoning approvals for a mixed-use development project to include up to approximately 50,000 square feet of retail space, 170,000 square feet of office space and 244 residential units. The Company has engaged architects and engineers and has substantially completed construction documents. A development timetable has not yet been finalized.

*Westview Village*

In January 2006, the Company contracted to purchase a 10.4 acre site in the Westview development on Buckeystown Pike (MD Route 85) in Frederick, Maryland. The purchase price is \$5.0 million and the closing of this land purchase is subject to the seller's completion of certain site work. Construction documents have been completed for development of a approximately 105,000 square feet of commercial space, including 60,000 square feet of retail shop space, 15,000 square feet of retail pads and 30,000 square feet of professional office space. The Company is currently marketing the space and has executed leases for 5,003 square feet of the retail space. The Company expects to commence construction upon closing of the land acquisition, subject to certain seller closing conditions being met, anticipated later in 2007.

*Great Eastern Plaza Land Parcel*

On June 6, 2007, the Company acquired 8.0 acres of undeveloped land adjacent to its Great Eastern Plaza shopping center in District Heights, Maryland, for a purchase price of \$1.3 million. The Company is analyzing options to expand the existing shopping center onto this parcel at some future date.

**Table of Contents****Portfolio Leasing Status**

The following chart sets forth certain information regarding the operating portfolio for the periods ended June 30, 2007 and 2006, respectively.

As of June 30,	Total Properties		Total Square Footage		Percent Leased	
	Shopping Centers	Office	Shopping Centers	Office	Shopping Centers	Office
2007	42	5	6,708,000	1,206,000	95.7%	96.0%
2006	41	5	6,481,000	1,206,000	96.6%	96.9%

The 2007 shopping center leasing percentage decreased primarily due to the departure of a 32,000 square foot local grocery anchor at Belvedere.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Company is exposed to certain financial market risks, the most predominant being fluctuations in interest rates. Interest rate fluctuations are monitored by management as an integral part of the Company's overall risk management program, which recognizes the unpredictability of financial markets and seeks to reduce the potentially adverse effect on the Company's results of operations. The Company does not enter into financial instruments for trading purposes.

The Company is exposed to interest rate fluctuations primarily as a result of any variable rate debt used to finance the Company's development and acquisition activities and for general corporate purposes. Interest rate fluctuations would affect the Company's annual interest expense on its variable rate debt. However, as of June 30, 2007, the Company had no variable rate indebtedness. Interest rate fluctuations will also affect the fair value of the Company's fixed rate debt instruments. As of June 30, 2007, the Company had fixed rate indebtedness totaling \$520,345,000. If interest rates on the Company's fixed rate debt instruments at June 30, 2007 had been one percent higher, the fair value of those debt instruments on that date would have decreased by approximately \$27,096,000.

**Item 4. Controls and Procedures**

The Company maintains disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in the Company's reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chairman and Chief Executive Officer, its Senior Vice President-Chief Financial Officer, Secretary and Treasurer, and its Vice President-Chief Accounting Officer as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of

## **Table of Contents**

disclosure controls and procedures in Rule 13a-15(e) promulgated under the Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

The Company carried out an evaluation under the supervision and with the participation of the Company's management, including its Chairman and Chief Executive Officer, its Senior Vice President-Chief Financial Officer, Secretary and Treasurer, and its Vice President-Chief Accounting Officer of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 30, 2007. Based on the foregoing, the Company's Chairman and Chief Executive Officer, its Senior Vice President-Chief Financial Officer, Secretary and Treasurer and its Vice President-Chief Accounting Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level as of June 30, 2007.

During the three months ended June 30, 2007, there were no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

None

### **Item 1A. Risk Factors**

The Company has no material updates to Item 1A. Risk Factors, as presented in the 2006 Annual Report of the Company on Form 10-K.

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

92,477 shares were acquired at a price of \$51.60 per share, by B. Francis Saul II, the Company's Chairman of the Board and Chief Executive Officer, and various individuals and entities affiliated with Mr. Saul II, through participation in the Company's Dividend Reinvestment and Stock Purchase Plan for the April 30, 2007 dividend distribution.

### **Item 3. Defaults Upon Senior Securities**

None



---

**Table of Contents**

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

On April 27, 2007, the Company held its Annual Meeting of Stockholders, at which Paul X. Kelley, Charles R. Longworth, Patrick F. Noonan and B. Francis Saul III were reelected to the Board of Directors for three year terms expiring at the 2010 Annual Meeting. The terms of the remaining Board members did not expire as of the April 27, 2007 meeting and those individuals continue as directors of the Company. Holders of 16,470,643 shares of the Company's common stock voted in person at the meeting or by proxy (representing 95.5% of outstanding shares) as follows; Mr. Kelley: in favor 16,412,676, withheld 57,967. Mr. Longworth: in favor 16,414,899, withheld 55,744. Mr. Noonan: in favor 16,417,960, withheld 52,683. Mr. Saul III: in favor 16,410,342, withheld 60,301. In addition, 16,418,608 voted in favor, 22,899 voted against and 29,136 abstained for ratification of Ernst & Young LLP as independent public accountants.

**Item 5. Other Information**

None

**Item 6. Exhibits**

3. (a) First Amended and Restated Articles of Incorporation of Saul Centers, Inc. filed with the Maryland Department of Assessments and Taxation on August 23, 1994 and filed as Exhibit 3.(a) of the 1993 Annual Report of the Company on Form 10-K are hereby incorporated by reference. Articles of Amendment to the First Amended and Restated Articles of Incorporation of Saul Centers, Inc., filed with the Maryland Department of Assessments and Taxation on May 28, 2004 and filed as Exhibit 3.(a) of the June 30, 2004 Quarterly Report of the Company is hereby incorporated by reference. Articles of Amendment to the First Amended and Restated Articles of Incorporation of Saul Centers, Inc., filed with the Maryland Department of Assessments and Taxation on May 26, 2006 and filed as Exhibit 3.(a) of the Company's Current Report on Form 8-K filed May 30, 2006 is hereby incorporated by reference.
- (b) Amended and Restated Bylaws of Saul Centers, Inc. as in effect at and after August 24, 1993 and as of August 26, 1993 and filed as Exhibit 3.(b) of the 1993 Annual Report of the Company on Form 10-K are hereby incorporated by reference. The First Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership, the Second Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership, the Third Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership and the Fourth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership as filed as Exhibit 3.(b) of the 1997 Annual Report of the Company on Form 10-K are hereby incorporated by reference.

**Table of Contents**

- (c) Articles Supplementary to First Amended and Restated Articles of Incorporation of the Company, dated October 30, 2003, filed as Exhibit 2 to the Company's Current Report on Form 8-A dated October 31, 2003, is hereby incorporated by reference.
- 4. (a) Deposit Agreement, dated November 5, 2003, among the Company, Continental Stock Transfer & Trust Company, as Depositary, and the holders of depositary receipts, each representing 1/100th of a share of 8% Series A Cumulative Redeemable Preferred Stock of Saul Centers, Inc. and filed as Exhibit 4 to the Registration Statement on Form 8-A on October 31, 2003 is hereby incorporated by reference.
- (b) Form specimen of receipt representing the depositary shares, each representing 1/100th of a share of 8% Series A Cumulative Redeemable Preferred Stock of Saul Centers, Inc. and included as part of Exhibit 4 to the Registration Statement on Form 8-A on October 31, 2003 is hereby incorporated by reference.
- 10. (a) First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit No. 10.1 to Registration Statement No. 33-64562 is hereby incorporated by reference. The First Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership, the Second Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership, and the Third Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of the 1995 Annual Report of the Company on Form 10-K is hereby incorporated by reference. The Fourth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of the March 31, 1997 Quarterly Report of the Company is hereby incorporated by reference. The Fifth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 4.(c) to Registration Statement No. 333-41436, is hereby incorporated by reference. The Sixth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of the September 30, 2003 Quarterly Report of the Company on Form 10-Q is hereby incorporated by reference. The Seventh Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of the December 31, 2003 Annual Report of the Company on Form 10-K is hereby incorporated by reference.

**Table of Contents**

- (b) First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership and Amendment No. 1 thereto filed as Exhibit 10.2 to Registration Statement No. 33-64562 are hereby incorporated by reference. The Second Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership, the Third Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership and the Fourth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership as filed as Exhibit 10.(b) of the 1997 Annual Report of the Company on Form 10-K are hereby incorporated by reference.
- (c) First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary II Limited Partnership and Amendment No. 1 thereto filed as Exhibit 10.3 to Registration Statement No. 33-64562 are hereby incorporated by reference. The Second Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary II Limited Partnership filed as Exhibit 10.(c) of the June 30, 2001 Quarterly Report of the Company is hereby incorporated by reference. The Third Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary II Limited Partnership as filed as exhibit 10.(c) of the 2006 Annual Report of the Company on Form 10-K are hereby incorporated by reference.
- (d) Property Conveyance Agreement filed as Exhibit 10.4 to Registration Statement No. 33-64562 is hereby incorporated by reference.
- (e) Management Functions Conveyance Agreement filed as Exhibit 10.5 to Registration Statement No. 33-64562 is hereby incorporated by reference.
- (f) Registration Rights and Lock-Up Agreement filed as Exhibit 10.6 to Registration Statement No. 33-64562 is hereby incorporated by reference.
- (g) Exclusivity and Right of First Refusal Agreement filed as Exhibit 10.7 to Registration Statement No. 33-64562 is hereby incorporated by reference.
- (h) Agreement of Assumption dated as of August 26, 1993 executed by Saul Holdings Limited Partnership and filed as Exhibit 10.(i) of the 1993 Annual Report of the Company on Form 10-K is hereby incorporated by reference.
- (i) Deferred Compensation Plan for Directors, dated as of April 23, 2004 and filed as Exhibit 10.(k) of the June 30, 2004 Quarterly Report of the Company is hereby incorporated by reference.
- (j) Loan Agreement dated as of November 7, 1996 by and among Saul Holdings Limited Partnership, Saul Subsidiary II Limited Partnership and PFL Life Insurance Company, c/o AEGON USA Realty Advisors, Inc., filed as Exhibit 10.(t) of the March 31, 1997 Quarterly Report of the Company, is hereby incorporated by reference.

**Table of Contents**

- (k) Promissory Note dated as of January 10, 1997 by and between Saul Subsidiary II Limited Partnership and The Northwestern Mutual Life Insurance Company, filed as Exhibit 10.(z) of the March 31, 1997 Quarterly Report of the Company, is hereby incorporated by reference.
- (l) Loan Agreement dated as of October 1, 1997 between Saul Subsidiary I Limited Partnership as Borrower and Nomura Asset Capital Corporation as Lender filed as Exhibit 10.(p) of the 1997 Annual Report of the Company on Form 10-K is hereby incorporated by reference.
- (m) Guaranty dated as of August 30, 2002 by and between Saul Centers, Inc. as Guarantor and U.S. Bank National Association, as administrative agent and sole lead arranger for itself and other financial institutions, the Lenders, as filed as Exhibit 10.(p) of the September 30, 2002 Quarterly Report of the Company, is hereby incorporated by reference.
- (n) Amended and Restated Promissory Note dated January 13, 2003 by and between Saul Holdings Limited Partnership as Borrower and Metropolitan Life Insurance Company as lender, as filed as Exhibit 10.(p) of the December 31, 2002 Annual Report of the Company on Form 10-K, is hereby incorporated by reference.
- (o) Revolving Credit Agreement, dated as of January 28, 2005, by and among Saul Holdings Limited Partnership as Borrower; U.S. Bank National Association, as Administrative Agent and Sole Lead Arranger; Wells Fargo Bank, National Association, as Syndication Agent; and U.S. Bank National Association, Wells Fargo Bank, National Association, Compass Bank, Sovereign Bank and First Horizon Bank, as Lenders, as filed as Exhibit 10.(q) of the Current Report of the Company on Form 8-K filed with the Commission on February 9, 2005, is hereby incorporated by reference.
- (p) Guaranty, dated as of February 1, 2005, by and between Saul Centers, Inc., as Guarantor, and U.S. Bank National Association, as Administrative Agent and Sole Lead Arranger for itself and other financial institutions as Lenders, as filed as Exhibit 10.(r) of the Current Report of the Company on Form 8-K filed with the Commission on February 9, 2005, is hereby incorporated by reference.
- (q) The Saul Centers, Inc. 2004 Stock Plan, as filed as Annex A to the Proxy Statement of the Company for its 2004 Annual Meeting of Stockholders, is hereby incorporated by reference.

**Table of Contents**

- (r) Form of Director Stock Option Agreements, as filed as Exhibit 10.(j) of the September 30, 2004 Quarterly Report of the Company, is hereby incorporated by reference.
- (s) Form of Officer Stock Option Grant Agreements, as filed as Exhibit 10.(k) of the September 30, 2004 Quarterly Report of the Company, is hereby incorporated by reference.
- 31. Rule 13a-14(a)/15d-14(a) Certifications of Chief Executive Officer and Chief Financial Officer (filed herewith)
- 32. Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer (filed herewith).
- 99. Schedule of Portfolio Properties

**Table of Contents**

SIGNATURES

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

SAUL CENTERS, INC.  
(Registrant)

Date: August 9, 2007

/s/ B. Francis Saul III  
B. Francis Saul III, President

Date: August 9, 2007

/s/ Scott V. Schneider  
Scott V. Schneider  
Senior Vice President, Chief Financial Officer  
(principal financial officer)

Date: August 9, 2007

/s/ Kenneth D. Shoop  
Kenneth D. Shoop  
Vice President, Chief Accounting Officer  
(principal accounting officer)