

SAUL CENTERS INC  
Form 10-Q  
August 06, 2010

**United States**  
**Securities and Exchange Commission**  
Washington, D.C. 20549

**FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the**  
**Securities Exchange Act of 1934**  
**For The Quarterly Period Ended June 30, 2010**  
**Commission File Number 1-12254**

**SAUL CENTERS, INC.**

(Exact name of registrant as specified in its charter)

**Maryland**  
(State or other jurisdiction of  
incorporation or organization)

7501 Wisconsin Avenue, Bethesda, Maryland 20814

**52-1833074**  
(I.R.S. Employer  
Identification No.)

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(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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

Number of shares of common stock, par value \$0.01 per share outstanding as of August 6, 2010: 18,349,000.

SAUL CENTERS, INC.

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

***Basis of Presentation***

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

## Saul Centers, Inc.

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)	June 30, 2010 (Unaudited)	December 31, 2009
<b>Assets</b>		
Real estate investments		
Land	\$ 232,188	\$ 223,193
Buildings and equipment	765,399	740,442
Construction in progress	155,738	147,589
	1,153,325	1,111,224
Accumulated depreciation	(288,252)	(276,310)
	865,073	834,914
Cash and cash equivalents	28,829	20,607
Accounts receivable and accrued income, net	35,146	37,503
Deferred leasing costs, net	14,840	15,609
Prepaid expenses, net	1,427	3,096
Deferred debt costs, net	7,025	7,537
Other assets	9,750	6,308
Total assets	\$ 962,090	\$ 925,574
<b>Liabilities</b>		
Mortgage notes payable	\$ 583,620	\$ 576,069
Construction loans payable	83,621	60,737
Dividends and distributions payable	12,302	12,220
Accounts payable, accrued expenses and other liabilities	27,322	23,395
Deferred income	26,270	27,090
Total liabilities	733,135	699,511
<b>Stockholders' equity</b>		
Preferred stock, 1,000,000 shares authorized:		
Series A Cumulative Redeemable, 40,000 shares issued and outstanding	100,000	100,000
Series B Cumulative Redeemable, 31,731 shares issued and outstanding	79,328	79,328
Common stock, \$0.01 par value, 30,000,000 shares authorized, 18,239,838 and 18,012,416 shares issued and outstanding, respectively	182	180
Additional paid-in capital	178,003	169,363
Accumulated deficit	(128,604)	(124,167)
Total Saul Centers, Inc. stockholders' equity	228,909	224,704
Noncontrolling interest	46	1,359
Total stockholders' equity	228,955	226,063
Total liabilities and stockholders' equity	\$ 962,090	\$ 925,574

The accompanying notes are an integral part of these statements



## Saul Centers, Inc.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(Dollars in thousands, except per share amounts)	For The Three Months Ended June 30,		For The Six Months Ended June 30,	
	2010	2009	2010	2009
<b>Revenue</b>				
Base rent	\$ 31,834	\$ 31,131	\$ 63,529	\$ 61,796
Expense recoveries	6,928	7,048	15,655	14,628
Percentage rent	331	328	689	561
Other	1,028	909	3,896	2,120
<b>Total revenue</b>	<b>40,121</b>	<b>39,416</b>	<b>83,769</b>	<b>79,105</b>
<b>Operating expenses</b>				
Property operating expenses	4,902	4,845	12,581	10,215
Provision for credit losses	157	232	354	559
Real estate taxes	4,452	4,620	9,137	9,036
Interest expense and amortization of deferred debt costs	8,887	8,782	17,478	16,978
Depreciation and amortization of deferred leasing costs	7,317	7,083	14,390	14,124
General and administrative	3,689	3,280	6,538	6,069
<b>Total operating expenses</b>	<b>29,404</b>	<b>28,842</b>	<b>60,478</b>	<b>56,981</b>
<b>Operating Income</b>	<b>10,717</b>	<b>10,574</b>	<b>23,291</b>	<b>22,124</b>
Loss on early extinguishment of debt	(4,479)	(1,660)	(4,479)	(1,660)
<b>Net Income</b>	<b>6,238</b>	<b>8,914</b>	<b>18,812</b>	<b>20,464</b>
<b>Noncontrolling interest</b>				
Income attributable to the noncontrolling interest	(565)	(1,195)	(2,586)	(3,004)
<b>Net income attributable to Saul Centers, Inc.</b>	<b>5,673</b>	<b>7,719</b>	<b>16,226</b>	<b>17,460</b>
Preferred dividends	(3,785)	(3,785)	(7,570)	(7,570)
<b>Net income available to common stockholders</b>	<b>\$ 1,888</b>	<b>\$ 3,934</b>	<b>\$ 8,656</b>	<b>\$ 9,890</b>
<b>Per share net income available to common stockholders</b>				
Basic	\$ 0.10	\$ 0.22	\$ 0.48	\$ 0.55
Diluted	\$ 0.10	\$ 0.22	\$ 0.47	\$ 0.55
<b>Dividends declared per common share outstanding</b>	<b>\$ 0.36</b>	<b>\$ 0.39</b>	<b>\$ 0.72</b>	<b>\$ 0.78</b>

The accompanying notes are an integral part of these statements

## Saul Centers, Inc.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited)

(Dollars in thousands, except per share amounts)	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total Saul Centers, Inc.	Noncontrolling Interest	Total
Balance, December 31, 2009	\$ 179,328	\$ 180	\$ 169,363	\$ (124,167)	\$ 224,704	\$ 1,359	\$ 226,063
Issuance of 112,736 shares of common stock:							
100,565 shares pursuant to dividend reinvestment plan		1	3,476		3,477		3,477
12,171 shares due to exercise of employee stock options and issuance of directors' deferred stock			400		400		400
Net income				10,553	10,553	2,021	12,574
Distributions payable preferred stock:							
Series A, \$50.00 per share				(2,000)	(2,000)		(2,000)
Series B, \$56.25 per share				(1,785)	(1,785)		(1,785)
Distributions payable common stock (\$0.36/share) and distributions payable partnership units (\$0.36/unit)				(6,526)	(6,526)	(1,949)	(8,475)
Balance, March 31, 2010	179,328	181	173,239	(123,925)	228,823	1,431	230,254
Issuance of 114,686 shares of common stock:							
103,496 shares pursuant to dividend reinvestment plan		1	4,042		4,043		4,043
11,190 shares due to exercise of employee stock options and issuance of directors' deferred stock			722		722		722
Net income				5,673	5,673	565	6,238
Distributions payable preferred stock:							
Series A, \$50.00 per share				(2,000)	(2,000)		(2,000)
Series B, \$56.25 per share				(1,785)	(1,785)		(1,785)
Distributions payable common stock (\$0.36/share) and distributions payable partnership units (\$0.36/unit)				(6,567)	(6,567)	(1,950)	(8,517)
Balance, June 30, 2010	\$ 179,328	\$ 182	\$ 178,003	\$ (128,604)	\$ 228,909	\$ 46	\$ 228,955

The accompanying notes are an integral part of these statements



## Saul Centers, Inc.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)	For The Six Months Ended June 30,	
	2010	2009
<b>Cash flows from operating activities:</b>		
Net income	\$ 18,812	\$ 20,464
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of deferred leasing costs	14,390	14,124
Amortization of deferred debt costs	786	1,089
Non cash compensation costs of stock grants and options	667	619
Provision for credit losses	354	559
Decrease in accounts receivable and accrued income	2,003	2,732
Increase in deferred leasing costs	(1,222)	(1,883)
Decrease in prepaid expenses	1,669	1,474
Increase in other assets	(3,442)	(6,779)
Increase in accounts payable, accrued expenses and other liabilities	1,959	3,101
(Decrease) increase in deferred income	(820)	297
Net cash provided by operating activities	35,156	35,797
<b>Cash flows from investing activities:</b>		
Additions to real estate investments	(2,229)	(4,548)
Additions to development and redevelopment activities	(38,361)	(33,359)
Net cash used in investing activities	(40,590)	(37,907)
<b>Cash flows from financing activities:</b>		
Proceeds from mortgage notes payable	45,600	86,882
Repayments on mortgage notes payable	(38,049)	(61,620)
Proceeds from revolving credit facility		30,000
Repayments on revolving credit facility		(15,000)
Proceeds from construction loans payable	22,884	13,499
Additions to deferred debt costs	(274)	(1,183)
Proceeds from the issuance of:		
Common stock	7,975	470
Distributions to:		
Series A preferred stockholders	(4,000)	(4,000)
Series B preferred stockholders	(3,570)	(3,570)
Common stockholders	(13,011)	(13,937)
Noncontrolling interest	(3,899)	(4,224)
Net cash provided by financing activities	13,656	27,317
Net increase in cash and cash equivalents	8,222	25,207
Cash and cash equivalents, beginning of period	20,607	13,006
Cash and cash equivalents, end of period	\$ 28,829	\$ 38,213

The accompanying notes are an integral part of these statements



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**Notes to Consolidated Financial Statements (Unaudited)**
**1. Organization, Formation and Structure**

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

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

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

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

As of June 30, 2010, the Company's properties (the Current Portfolio Properties) consisted of 47 operating shopping center properties (the Shopping Centers), five predominantly office operating properties (the Office Properties) and four (non-operating) land or development properties.

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

**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

**2. Summary of Significant Accounting Policies**

***Nature of Operations***

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

Because the properties are located primarily in the Washington, DC/Baltimore metropolitan area, the Company is subject to a concentration of credit risk related to these properties. A majority of the Shopping Centers are anchored by several major tenants. As of June 30, 2010, thirty-two of the Shopping Centers were anchored by a grocery store and offer primarily day-to-day necessities and services. Three retail tenants, Giant Food (4.4%), a tenant at seven Shopping Centers, Safeway (3.3%), a tenant at eight Shopping Centers and Chevy Chase Bank (2.7%), a tenant at twenty properties, and one office tenant, the United States Government (2.6%), a tenant at six properties, individually accounted for 2.5% or more of the Company's total revenue for the six months ended June 30, 2010.

***Principles of Consolidation***

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

***Basis of Presentation***

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

***Use of Estimates***

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

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**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

***Real Estate Investment Properties***

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

If there is an event or change in circumstance that indicates an impairment in the value of a real estate investment property, the Company prepares an impairment analysis to determine that the carrying value of the real estate investment property does not exceed its estimated fair value. The Company considers both quantitative and qualitative factors including recurring operating losses, significant decreases in occupancy, and significant adverse changes in legal factors and business climate. If impairment indicators are present, the Company compares the projected cash flows of the property over its remaining useful life, on an undiscounted basis, to the carrying value of that property. The Company assesses its undiscounted projected cash flows based upon estimated capitalization rates, historic operating results and market conditions that may affect the property. If such carrying value is greater than the undiscounted projected cash flows, the Company would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its then estimated fair value. The value of any property is sensitive to the actual results of any of the aforementioned estimated factors, either individually or taken as a whole. Should the actual results differ from management's projections, the valuation could be negatively or positively affected. The Company did not recognize an impairment loss on any of its real estate during the three or six month periods ended June 30, 2010 and 2009.

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

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**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

totaled approximately \$3,421,000 and \$2,869,000, for the six month periods ended June 30, 2010 and 2009, respectively. A project is considered substantially complete and available for occupancy upon completion of tenant improvements, but no later than one year from the cessation of major construction activity. Substantially completed portions of a project are accounted for as separate projects.

Depreciation is calculated using the straight-line method and estimated useful lives of 35 to 50 years for base buildings and up to 20 years for certain other improvements that extend the useful lives. In addition, the Company capitalizes leasehold improvements when certain criteria are met, including when we supervise construction and will own the improvements. Tenant improvements are amortized, over the shorter of the lives of the related leases or the useful life of the improvements, using the straight-line method. The depreciation component included in depreciation and amortization expense in the consolidated statements of operations totaled approximately \$12,399,000 and \$11,767,000, for the six month periods ended June 30, 2010 and 2009, respectively. Repair and maintenance expense, included in property operating expenses, for the six month periods ended June 30, 2010 and 2009, was approximately \$7,080,000 and \$4,669,000, respectively.

***Assets Held for Sale***

The Company considers properties to be assets held for sale when all of the following criteria are met:

management commits to a plan to sell a property;

it is unlikely that the disposal plan will be significantly modified or discontinued;

the property is available for immediate sale in its present condition;

actions required to complete the sale of the property have been initiated;

sale of the property is probable and we expect the completed sale will occur within one year; and

the property is actively being marketed for sale at a price that is reasonable given its current market value.

Upon designation as an asset held for sale, the Company records the carrying value of each property at the lower of its carrying value or its estimated fair value, less estimated costs to sell, and we cease depreciation. As of June 30, 2010, no properties were classified as held for sale.

***Deferred Leasing Costs***

Deferred leasing costs consist of commissions paid to third-party leasing agents, internal direct costs such as employee compensation and payroll-related fringe benefits directly related to time spent performing leasing-related activities for successful leases and amounts attributed to in place leases associated with acquired properties. Leasing related activities include evaluating the prospective tenant's financial condition, evaluating and recording guarantees, collateral and other

**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

security arrangements, negotiating lease terms, preparing lease documents and closing the transaction. The carrying amount of these costs is written-off to expense if the applicable lease is terminated prior to expiration of the initial lease term. Deferred leasing costs are amortized over the initial term of the lease or remaining initial term of acquired leases. Collectively, deferred leasing costs totaled \$14,840,000 and \$15,609,000, net of accumulated amortization of \$15,673,000 and \$14,889,000, as of June 30, 2010 and December 31, 2009, respectively. Amortization expense, included in depreciation and amortization in the consolidated statements of operations, totaled \$1,991,000 and \$2,357,000, for the six months ended June 30, 2010 and 2009, respectively.

***Construction In Progress***

Construction in progress includes preconstruction costs and development costs of active projects. Preconstruction costs associated with these projects include legal, zoning and permitting costs and other project carrying costs incurred prior to the commencement of construction. Development costs include direct construction costs and indirect costs incurred subsequent to the start of construction such as architectural, engineering, construction management and carrying costs consisting of interest, real estate taxes and insurance. Construction in progress balances as of June 30, 2010 and December 31, 2009 are as follows:

*Construction in Progress*

<b>(Dollars in thousands)</b>	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Clarendon Center	\$ 155,021	\$ 115,810
Northrock		11,910
Westview Village		18,730
Other	717	1,139
<b>Total</b>	<b>\$ 155,738</b>	<b>\$ 147,589</b>

***Accounts Receivable, Accrued Income and Allowance for Doubtful Accounts***

Accounts receivable primarily represent amounts currently due from tenants in accordance with the terms of the respective leases. Receivables are reviewed monthly and reserves are established with a charge to current period operations when, in the opinion of management, collection of the receivable is doubtful. Accounts receivable in the accompanying financial statements are shown net of an allowance for doubtful accounts of approximately \$831,000 and \$1,265,000, at June 30, 2010 and December 31, 2009, respectively.

In addition to rents due currently, accounts receivable includes approximately \$27,424,000 and \$27,154,000, at June 30, 2010 and December 31, 2009, respectively, net of allowance for doubtful accounts totaling \$12,000 and \$15,000, respectively, representing minimum rental income accrued on a straight-line basis to be paid by tenants over the remaining term of their respective leases.

**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

***Cash and Cash Equivalents***

Cash and cash equivalents include short-term investments. Short-term investments include money market accounts and other investments which generally mature within three months, measured from the acquisition date, and/or are readily convertible to cash. Substantially all of the Company's cash balances at June 30, 2010 are held in non-interest bearing accounts at various banks.

***Deferred Debt Costs***

Deferred debt costs consist of fees and costs incurred to obtain long-term financing, construction financing and the revolving line of credit. These fees and costs are being amortized on a straight-line basis over the terms of the respective loans or agreements, which approximates the effective interest method. Deferred debt costs totaled \$7,025,000 and \$7,537,000, net of accumulated amortization of \$4,736,000 and \$5,161,000, at June 30, 2010 and December 31, 2009, respectively.

***Deferred Income***

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

***Revenue Recognition***

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

***Income Taxes***

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



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**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

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

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

At the annual meeting of the Company's stockholders in 2004, the stockholders approved the adoption of the 2004 stock plan for the purpose of attracting and retaining executive officers, directors and other key personnel. The 2004 stock plan was subsequently amended by the Company's stockholders at the 2008 Annual Meeting (the Amended 2004 Plan) and expires in April 2018. Pursuant to the Amended 2004 Plan, the Compensation Committee established a Deferred Compensation Plan for Directors for the benefit of its directors and their beneficiaries, which replaced a previous Deferred Compensation and Stock Plan for Directors. A director may make an annual election to defer all or part of his or her director's fees and has the option to have the fees paid in cash, in shares of common stock or in a combination of cash and shares of common stock upon termination from the Board. If the director elects to have fees paid in stock, fees earned during a calendar quarter are aggregated and divided by the common stock's closing market price on the first trading day of the following quarter to determine the number of shares to be allocated to the director. As of June 30, 2010, 224,000 shares had been credited to the directors' deferred fee accounts.

The Compensation Committee has also approved an annual award of shares of the Company's common stock as additional compensation to each director serving on the Board of Directors as of the record date for the Annual Meeting of Stockholders. The shares are awarded as of each Annual Meeting of Shareholders, and their issuance may not be deferred. Each director was issued 200 shares at the 2010 Annual Meeting of Shareholders. The shares were valued at the closing stock price on the date the shares were awarded and included in general and administrative expenses.

***Derivative Financial Instruments***

The Company may use derivative instruments to manage its exposure to market risk such as changes in interest rates. The Company does not enter into derivative transactions for trading or speculative purposes. Derivative financial instruments are carried at fair value as either assets or liabilities on the consolidated balance sheets. For those derivative instruments that are designated, and qualify, as hedging instruments, we designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge or a cash flow hedge. For derivative

**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

instruments that do not meet the criteria for hedge accounting, changes in fair value are immediately recognized in earnings. For those derivative instruments that qualify for hedge accounting, the effective portion of the gain or loss on the hedge instruments is reported as a component of accumulated other comprehensive income (loss) and recognized in earnings within the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings. Any ineffective portion of a derivative's change in fair value is immediately recognized in earnings. To the extent that the financial terms of the hedge instrument and the hedged item exactly match, we may employ the so-called "short-cut" method of accounting for the arrangement. In that case, the effectiveness of the hedge is not subsequently evaluated and the impact of the hedge instrument is reported together with the activity of the hedged item in the consolidated statements of operations.

Derivative financial instruments expose us to credit risk in the event of non-performance by the counterparties under the terms of the derivative instrument. We minimize our credit risk on these transactions by dealing with major, creditworthy financial institutions as determined by management, and therefore, we believe that the likelihood of realizing losses from counterparty non-performance is remote.

***Noncontrolling Interest***

Saul Centers is the sole general partner of the Operating Partnership, owning a 77.1% common interest as of June 30, 2010. Noncontrolling interest in the Operating Partnership is comprised of limited partnership units owned by The Saul Organization. Noncontrolling interest as reflected on the accompanying consolidated balance sheets is increased for earnings allocated to limited partnership interests and distributions reinvested in additional units, and is decreased for limited partner distributions. Noncontrolling interest as reflected on the consolidated statements of operations represent earnings allocated to limited partnership interests held by the Saul Organization.

***Per Share Data***

Per share data for net income (basic and diluted) is computed using weighted average shares of common stock. Convertible limited partnership units and employee stock options are the Company's potentially dilutive securities. For all periods presented, the convertible limited partnership units are non-dilutive. Certain options are dilutive because the average share price of the Company's common stock exceeded the exercise prices. The treasury stock method was used to measure the effect of the dilution. As of June 30, 2010, the stock options issued in 2006, 2007 and 2008 are anti-dilutive and are therefore excluded from this measurement.

## Notes to Consolidated Financial Statements (Unaudited) (Continued)

*Basic and Diluted Shares Outstanding*

(In thousands)	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Weighted average common shares outstanding-Basic	18,203	17,882	18,144	17,876
Effect of dilutive options	109	35	95	32
Weighted average common shares outstanding-Diluted	18,312	17,917	18,239	17,908

*Reclassifications*

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

*Legal Contingencies*

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

*New Accounting Standards*

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

**3. Real Estate Acquired or Developed***Westview Village*

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

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**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

***Northrock***

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

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

Certain members of The Saul Organization are limited partners of the Operating Partnership, collectively owning a 22.9% common interest as of June 30, 2010, represented by approximately 5,416,000 convertible limited partnership units. These units are convertible into shares of Saul Centers common stock, at the option of the unit holder, on a one-for-one basis provided that, in accordance with the Saul Centers, Inc. Articles of Incorporation, the rights may not be exercised at any time that The Saul Organization beneficially owns, directly or indirectly, in the aggregate more than 39.9% of the value of the outstanding common stock and preferred stock of Saul Centers (the Equity Securities). As of June 30, 2010, 4,504,000 units were convertible into shares of Saul Centers common stock.

The impact of The Saul Organization's approximately 22.9% limited partnership interest in the Operating Partnership is reflected as Noncontrolling Interest in the accompanying consolidated financial statements. Fully converted partnership units and diluted weighted average shares outstanding for the quarters ended June 30, 2010 and 2009, were approximately 23,728,000 and 23,333,000, respectively and for the six months ended June 30, 2010 and 2009, were approximately 23,655,000 and 23,324,000, respectively.

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

The Company's outstanding debt totaled approximately \$667,241,000 at June 30, 2010, of which approximately \$583,620,000 was fixed-rate debt and approximately \$83,621,000 was variable rate debt.

In addition to the outstanding indebtedness at June 30, 2010, the Company had a \$150 million unsecured revolving credit facility, which can be used for working capital, property acquisitions or development projects, with no outstanding borrowings. The revolving credit facility matures on June 30, 2012, and may be extended by the Company for one additional year subject to the Company's satisfaction of certain conditions. Saul Centers and certain consolidated subsidiaries of the Operating Partnership have guaranteed the payment obligations of the Operating Partnership under the revolving credit facility. Letters of credit may be issued under the revolving credit facility. On June 30, 2010, of the \$150,000,000 available for borrowing, approximately \$177,000 was committed for letters of credit and approximately \$149,823,000 was available under the line. Interest rate pricing under the facility is primarily determined based on the level of operating income generated by the Company's existing unencumbered properties and, to a lesser extent, certain leverage tests. As of June 30, 2010, operating income from the unencumbered properties determined the interest rate for up to \$105,000,000 of the line's available borrowings, with interest expense to be calculated based

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**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

upon the 1, 2, 3 or 6 month LIBOR plus a spread of 3.65% to 3.90%. The interest rate on the remaining \$45,000,000 of the line's availability is determined based upon the Company's consolidated operating income after debt service. On this portion of the facility, interest accrues at a rate of LIBOR plus a spread of 4.45% to 5.25%, determined by certain leverage tests. The Company may elect to use the 1, 2, 3 or 6 month LIBOR, but in no event shall LIBOR be less than 1.5%.

Saul Centers is a guarantor of the revolving credit facility, of which the Operating Partnership is the borrower. Saul Centers is also the guarantor of 50% of the Northrock construction loan (approximately \$9,705,000 of the \$19,409,000 outstanding at June 30, 2010) and the Clarendon Center construction loan (approximately \$64,212,000 outstanding at June 30, 2010). The fixed-rate notes payable are all non-recourse debt except for \$3,882,000 of the Great Falls Center mortgage, which is guaranteed by Saul Centers.

On June 29, 2010, the Company closed on a new 10-year mortgage loan in the amount of \$45,600,000, secured by Thruway. The loan matures July 1, 2020, bears interest at a variable rate equal to the sum of one-month LIBOR and 260 basis points, requires equal monthly principal and interest payments of \$289,081, based upon an assumed interest rate of 5.83% and a 25-year principal amortization, and requires a final principal payment of approximately \$34,753,000 at maturity. In conjunction with the financing, the Company entered into an interest rate swap agreement with a \$45,600,000 notional amount to manage the interest rate risk associated with the above \$45,600,000 of variable-rate mortgage debt. The swap agreement was effective July 1, 2010, terminates on July 1, 2020 and effectively fixes the interest rate on the mortgage debt at 5.83%. Because the interest-rate swap effectively fixes the interest cost of the mortgage loan, unless otherwise indicated, the loan will be treated as fixed-rate debt for disclosure purposes. The fair value of the swap agreement was not material as of June 30, 2010. The Company has designated this agreement as a cash flow hedge for accounting purposes. The critical terms of the interest rate swap match the terms of the variable-rate mortgage debt and, as a result, the hedge has been deemed to be perfectly effective and the arrangement satisfies the criteria for the so-called short-cut method of accounting. The Company, therefore, will recognize interest expense on the variable-rate debt at the effective fixed rate of 5.83% and will not test the hedge for effectiveness in future periods.

Prior to the refinancing, Thruway was one of nine properties securing a collateralized mortgage-backed security (CMBS) with an outstanding balance of \$108,324,000, an interest rate of 7.67% and due to mature October 2012. In order to release Thruway, the Company entered into a transaction to defease \$30,179,000 of the outstanding balance at a cost of approximately \$4,425,000, using proceeds from the new mortgage financing.

In May 2010, the Company committed to borrow \$17,000,000 under a mortgage loan to refinance existing debt due to mature October 2012 and secured by Ravenwood. Subject to standard closing requirements, the loan is expected to close by December 15, 2010, will have a term of 15 years and have monthly interest and principal payments of \$111,409 based upon a fixed interest rate of 6.18% and a 25-year amortization schedule.

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

Notes to Consolidated Financial Statements (Unaudited) (Continued)

At June 30, 2010, the scheduled maturities of all debt, including scheduled principal amortization, for years ending December 31, were as follows:

*Debt Maturity Schedule*

(Dollars in thousands)	Balloon Payments	Scheduled Principal Amortization	Total
July 1 through December 31, 2010	\$	\$ 6,645	\$ 6,645
2011	83,621 <sup>(a)</sup>	17,676	101,297
2012	69,014	16,542	85,556
2013	39,629	12,174	51,803
2014	13,218	12,327	25,545
2015	15,074	12,473	27,547
Thereafter	288,587	80,261	368,848
	\$ 509,143	\$ 158,098	\$ 667,241

(a) Represents the Clarendon Center and Northrock construction loan balances as of June 30, 2010, both of which may be extended upon achievement of certain construction and/or leasing requirements.

Interest expense and amortization of deferred debt costs for the three and six month periods ended June 30, 2010 and 2009, were as follows:

*Interest Expense and Amortization of Deferred Debt Costs*

(Dollars in thousands)	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Interest incurred	\$ 10,115	\$ 9,720	\$ 20,167	\$ 18,976
Amortization of deferred debt costs	365	292	732	591
Costs related to the modification of revolving credit facility		280		280
Capitalized interest	(1,593)	(1,510)	(3,421)	(2,869)
	\$ 8,887	\$ 8,782	\$ 17,478	\$ 16,978

**6. Stockholders Equity and Noncontrolling Interest**

The consolidated statements of operations for the six months ended June 30, 2010 and 2009 reflect noncontrolling interest of \$2,586,000 and \$3,004,000, respectively, representing The Saul Organization's share of net income for each period.

In November 2003, the Company sold 4,000,000 depositary shares, each representing 1/100th of a share of 8% Series A Cumulative Redeemable Preferred Stock. The depositary

**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

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

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

**7. Related Party Transactions**

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

The Company participates in a multiemployer 401K plan with entities in The Saul Organization which covers those full-time employees who meet the requirements as specified in the plan. Company contributions, which are included in general and administrative expense or property operating expenses in the consolidated statements of operations, at the discretionary amount of up to six percent of the employee's cash compensation, subject to certain limits, were \$207,000 and \$223,000, for the six months ended June 30, 2010 and 2009, respectively. All amounts deferred by employees and the Company are fully vested.

The Company also participates in a multiemployer nonqualified deferred compensation plan with entities in The Saul Organization which covers those full-time employees who meet the requirements as specified in the plan. According to the plan, which can be modified or discontinued at any time, participating employees defer 2% of their compensation in excess of a specified amount. For the six months ended June 30, 2010 and 2009, the Company contributed three times the amount deferred by employees. The Company's expense, included in general and administrative expense, totaled \$89,000 and \$119,000, for the six months ended June 30, 2010 and 2009, respectively. All amounts deferred by employees and the Company are fully vested. The cumulative unfunded liability under this plan was \$1,467,000 and \$1,371,000, at June 30, 2010 and December 31, 2009, respectively, and is included in accounts payable, accrued expenses and other liabilities in the consolidated balance sheets.

**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

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 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, 2010 and 2009, which included rental expense for the Company's headquarters lease, totaled approximately \$2,999,000 and \$2,816,000, respectively. The amounts are expensed as incurred and are primarily reported as general and administrative expenses in these consolidated financial statements. As of June 30, 2010 and December 31, 2009, accounts payable, accrued expenses and other liabilities included approximately \$376,000 and \$525,000, respectively, representing amounts due to The Saul Organization for the Company's share of these ancillary costs and expenses.

The Company's corporate headquarters space is leased by a member of The Saul Organization. The 10-year lease, which commenced in March 2002, provides for base rent increases of 3% per year, with payment of a pro-rata share of operating expenses over a base year amount. The Company and The Saul Organization entered into a Shared Services Agreement whereby each party pays an allocation of total rental payments based on a percentage proportionate to the number of employees employed by each party. The Company's rent expense for the six months ended June 30, 2010 and 2009 was approximately \$435,000 and \$420,000, respectively, and is included in general and administrative expense.

The B. F. Saul Insurance Agency of Maryland, Inc., a subsidiary of the B. F. Saul Company and a member of The Saul Organization, is a general insurance agency that receives commissions and fees in connection with the Company's insurance program. Such commissions and fees amounted to \$97,000 and \$104,000 for the six months ended June 30, 2010 and 2009, respectively.

**8. Stock Option Plans**

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





## Notes to Consolidated Financial Statements (Unaudited) (Continued)

The table below summarizes the option activity for the six months ended June 30, 2010:

	Number of Shares	Wtd Avg Exercise Price/sh	Aggregate Intrinsic Value
Outstanding at January 1	609,253	\$ 36.72	
Granted	32,500	38.76	
Exercised	(17,472)	26.05	\$ 236,000
Expired/Forfeited			
Outstanding June 30	624,281	37.12	4,541,000
Exercisable at June 30	593,656	36.24	4,541,000

The intrinsic value 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 intrinsic value for shares exercised during the period was calculated by using the closing share price on the date of exercise. At June 30, 2010, the closing share price of \$40.63 was lower than the exercise price of options granted in 2007 and 2008 and, therefore, those options had no intrinsic value as of June 30, 2010. The weighted average remaining contractual life of the Company's outstanding and exercisable options is 5.5 and 5.4 years, respectively.

#### 9. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses are reasonable estimates of their fair value. Based upon management's estimate of borrowing rates and loan terms currently available to the Company for fixed-rate financing, the aggregate fair value of the notes payable with fixed-rate payment terms, assuming long-term interest rates of approximately 6.0% and 7.3%, would be approximately \$600,094,000 and \$553,257,000, respectively, compared to the carrying value of \$583,620,000 and \$576,069,000, at June 30, 2010 and December 31, 2009, respectively.

The Company carries its interest rate swap at fair value. The Company has determined the majority of the inputs used to value its derivative fall within Level 2 of the fair value hierarchy with the exception of the impact of counter-party risk, which was determined using Level 3 inputs and are not significant. As of June 30, 2010, the fair value of the interest-rate swap was not material.

#### 10. 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.

## Notes to Consolidated Financial Statements (Unaudited) (Continued)

## 11. Business Segments

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

(Dollars in thousands)	Shopping Centers	Office Properties	Corporate and Other (1)	Consolidated Totals
<b>Quarter ended June 30, 2010</b>				
Real estate rental operations:				
Revenue	\$ 30,195	\$ 9,926	\$	\$ 40,121
Expenses	(6,603)	(2,908)		(9,511)
Income from real estate	23,592	7,018		30,610
Interest expense and amortization of deferred debt costs			(8,887)	(8,887)
General and administrative			(3,689)	(3,689)
Subtotal	23,592	7,018	(12,576)	18,034
Depreciation and amortization of deferred leasing costs	(5,197)	(2,120)		(7,317)
Loss on early extinguishment of debt			(4,479)	(4,479)
Net income	\$ 18,395	\$ 4,898	\$ (17,055)	\$ 6,238
Capital investment	\$ 965	\$ 391	\$ 20,504	\$ 21,860
Total assets	\$ 663,100	\$ 112,820	\$ 186,170	\$ 962,090
<b>Quarter ended June 30, 2009</b>				
Real estate rental operations:				
Revenue	\$ 29,697	\$ 9,716	\$ 3	\$ 39,416
Expenses	(6,948)	(2,749)		(9,697)
Income from real estate	22,749	6,967	3	29,719
Interest expense and amortization of deferred debt costs			(8,782)	(8,782)
General and administrative			(3,280)	(3,280)
Subtotal	22,749	6,967	(12,059)	17,657
Depreciation and amortization of deferred leasing costs	(5,116)	(1,967)		(7,083)
Loss on early extinguishment of debt			(1,660)	(1,660)
Net income	\$ 17,633	\$ 5,000	\$ (13,719)	\$ 8,914
Capital investment	\$ 8,017	\$ 420	\$ 12,013	\$ 20,450
Total assets	\$ 672,816	\$ 109,454	\$ 123,181	\$ 905,451

- (1) Includes Clarendon Center development activity.

## Notes to Consolidated Financial Statements (Unaudited) (Continued)

(Dollars in thousands)	Shopping Centers	Office Properties	Corporate and Other (1)	Consolidated Totals
<b>Six months ended June 30, 2010</b>				
Real estate rental operations:				
Revenue	\$ 64,244	\$ 19,525	\$	\$ 83,769
Expenses	(16,300)	(5,772)		(22,072)
Income from real estate	47,944	13,753		61,697
Interest expense and amortization of deferred debt costs			(17,478)	(17,478)
General and administrative			(6,538)	(6,538)
Subtotal	47,944	13,753	(24,016)	37,681
Depreciation and amortization of deferred leasing costs	(10,311)	(4,079)		(14,390)
Loss on early extinguishment of debt			(4,479)	(4,479)
Net income	\$ 37,633	\$ 9,674	\$ (28,495)	\$ 18,812
Capital investment	\$ 2,606	\$ 944	\$ 37,040	\$ 40,590
Total assets	\$ 663,100	\$ 112,820	\$ 186,170	\$ 962,090
<b>Six months ended June 30, 2009</b>				
Real estate rental operations:				
Revenue	\$ 59,424	\$ 19,675	\$ 6	\$ 79,105
Expenses	(14,242)	(5,568)		(19,810)
Income from real estate	45,182	14,107	6	59,295
Interest expense and amortization of deferred debt costs			(16,978)	(16,978)
General and administrative			(6,069)	(6,069)
Subtotal	45,182	14,107	(23,041)	36,248
Depreciation and amortization of deferred leasing costs	(10,131)	(3,993)		(14,124)
Loss on early extinguishment of debt			(1,660)	(1,660)
Net income	\$ 35,051	\$ 10,114	\$ (24,701)	\$ 20,464
Capital investment	\$ 17,240	\$ 676	\$ 19,991	\$ 37,907
Total assets	\$ 672,816	\$ 109,454	\$ 123,181	\$ 905,451

(1) Includes Clarendon Center development activity.

**Notes to Consolidated Financial Statements (Unaudited) (Continued)**

**12. Subsequent Events**

The Company has reviewed operating activities for the period subsequent to June 30, 2010 and prior to the date the financial statements are issued or are available to be issued, and determined there are no subsequent events required to be disclosed.

**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, 2009. 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:

continuing risks related to the challenging domestic and global credit markets and their effect on discretionary spending;

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

such other risks as described in Part I, Item 1A of our Form 10-K for the year ended December 31, 2009.





**General**

The following discussion is based primarily on the consolidated financial statements of the Company as of June 30, 2010 and for the three month period ended June 30, 2010.

**Overview**

The Company's principal business activity is the ownership, management and development of income-producing properties. The Company's long-term objectives are to increase cash flow from operations and to maximize capital appreciation of its real estate investments.

The Company's primary operating strategy is to focus on its community and neighborhood shopping center business and to operate its properties to achieve both cash flow growth and capital appreciation. Management believes there is potential for growth in cash flow as existing leases for space in the Shopping Centers expire and are renewed, or newly available or vacant space is leased. The Company intends to renegotiate leases where possible and seek new tenants for available space in order to maximize this potential for increased cash flow. As leases expire, management expects to revise rental rates, lease terms and conditions, relocate existing tenants, reconfigure tenant spaces and introduce new tenants with the goal of increasing cash flow. In those circumstances in which leases are not otherwise expiring, management selectively attempts to increase cash flow through a variety of means, or in connection with renovations or relocations, recapturing leases with below market rents and re-leasing at market rates, as well as replacing financially troubled tenants. When possible, management also will seek to include scheduled increases in base rent, as well as percentage rental provisions, in its leases.

The Company's redevelopment and renovation objective is to selectively and opportunistically redevelop and renovate its properties, by replacing tenant leases with below-market rents with strong, traffic-generating anchor stores such as supermarkets and drug stores, as well as other desirable local, regional and national tenants. The Company's strategy remains focused on continuing the operating performance and internal growth of its existing Shopping Centers, while enhancing this growth with selective retail redevelopments and renovations.

In light of the limited amount of quality properties for sale that the Company has been presented with or inquired about over the past year, management believes acquisition and development opportunities for investment in existing and new shopping center and office properties in the near future is uncertain. However, because of its conservative capital structure, including its undrawn credit line and cash balances, management believes that the Company is positioned to take advantage of investment opportunities when available. It is management's view that several of the sub-markets in which the Company operates have attractive supply/demand characteristics. The Company will continue to evaluate acquisition, development and redevelopment as an integral part of its overall business plan.

Although there has been a downturn in the national real estate market, to date, the effects on the office and retail markets in the metropolitan Washington, D.C. area, where the majority of the Company's properties are located, have been less severe. However, continued stagnation in the local economies where the Company's properties are located may lead to increased tenant bankruptcies, increased vacancies and decreased rental rates.

With a severe decline in overall consumer spending, retailers continue to struggle with declining sales and limited access to capital. Vacancies remain high compared to years prior to the recent economic downturn. Our overall portfolio leasing percentage at June 30, 2010, on a comparative same center basis (excluding recently developed properties which have not yet stabilized; Northrock and Westview), was 92.9%, compared to 93.1% at June 30, 2009 and an average of 95.7% for the three years prior to 2009.

The Company's tenants were further impacted by winter weather, as heavy snowfall in the Mid-Atlantic states during the retail holiday season in late December 2009 hindered the ability of customers to shop. Additionally, the costs of removing the snow from the shopping centers and office buildings approached \$1,000,000. Compounding the costs of the December storm were two major storms impacting the Mid-Atlantic region during February 2010. Including these storms, the costs of removing snow from the Company's properties during the quarter ended March 31, 2010 approached \$3,100,000. Approximately 60% of these costs were billed to tenants.

During the second quarter, the Company's French Market property suffered significant roof damage during a violent hail storm. The Company is in the process of obtaining bids to repair the damage and estimates that the cost will exceed \$2,300,000, which is fully covered by insurance subject to a \$10,000 deductible. Final determination of the extent of the damage and the identification of assets that will be replaced is expected to occur in the third quarter, at which time the Company plans to recognize a gain equal to the excess of the amount of insurance proceeds over the carrying value of the replaced assets. All tenants remained open for business throughout the aftermath of the hail storm.

In June 2010, the Company received and accepted an unsolicited offer to purchase the Lexington Center land parcel and Lexington pads. The purchaser is currently conducting its due diligence and the offer is subject to cancellation based on that due diligence. Accordingly, the properties have not been classified as held for sale. If the transaction goes forward, the properties are expected to be sold for approximately \$8,000,000, which is in excess of their \$4,500,000 million carrying value, with closing expected to occur no later than the 1<sup>st</sup> quarter of 2011. There is no debt associated with the properties as of June 30, 2010.

In addition, because of the Company's conservative capital structure, the Company has not been significantly affected by the recent turmoil in the credit markets. First, the Company maintains a ratio of total debt to total assets value of under 50%, which allows the Company to obtain additional secured borrowings if necessary. Second, as of June 30, 2010, amortizing fixed-rate mortgage debt represented approximately 87% of the Company's notes payable, thus minimizing refinancing risk. Third, the Company's earliest fixed-rate debt maturity is not until October 2012 and the Company's two construction loans for Northrock and Clarendon Center may be extended, under certain conditions, until May 2013. Finally, as of June 30, 2010, the Company has loan availability of more than \$149,000,000 under its \$150,000,000 unsecured revolving line of credit.

Although it is management's present intention to concentrate future acquisition and development activities on community and neighborhood shopping centers and office properties in the Washington, DC/Baltimore metropolitan area and the southeastern region of the United States, the Company may, in the future, also acquire other types of real estate in other areas of the country as opportunities present themselves. While the Company may diversify in terms of property locations, size and market, the Company does not set any limit on the amount or percentage of Company assets that may be invested in any one property or any one geographic area.

### ***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 historical cost less depreciation. The Company intends to own its real estate investment properties over a long term. No real estate investment properties have been sold since the Company's formation in 1993. Management believes that these assets have generally appreciated in value since their acquisition or development and, accordingly, management believes 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 U.S. GAAP, they do not report the current value of the Company's real estate investment properties.

The Company purchases real estate investment properties from time to time and allocates the purchase price to various components, such as land, buildings, and intangibles related to in-place leases and customer relationships, based on the 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 above and below market

leases, the Company considers the remaining contractual lease period and renewal periods, taking into consideration the likelihood of the tenant exercising its renewal options. The fair value of a below market lease component is recorded as deferred income and amortized as additional lease revenue over the remaining contractual lease period and any renewal option periods included in the valuation analysis. The fair value of above market lease intangibles is recorded as a deferred asset and is amortized as a reduction of lease revenue over the remaining contractual lease term. The Company determines the fair value of at-market in-place leases considering the cost of acquiring similar leases, the foregone rents associated with the lease-up period and carrying costs associated with the lease-up period. Intangible assets associated with at-market in-place leases are amortized as additional expense over the remaining contractual lease term. To the extent customer relationship intangibles are present in an acquisition, the fair value of the intangibles is amortized over the life of the customer relationship.

If there is an event or change in circumstance that indicates an impairment in the value of a real estate investment property, the Company prepares an impairment analysis to assess the carrying value of the real estate investment property relative to its estimated fair value. The Company considers both quantitative and qualitative factors in identifying impairment indicators including recurring operating losses, significant decreases in occupancy, and significant adverse changes in legal factors and business climate. If impairment indicators are present, the Company compares the projected cash flows of the property over its remaining useful life, on an undiscounted basis, to the carrying value of that property. The Company assesses its undiscounted projected cash flows based upon estimated capitalization rates, historic operating results and market conditions that may affect the property. If such carrying value is greater than the undiscounted projected cash flows, the Company would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its then estimated fair market value. The value of any property is sensitive to the actual results of any of the aforementioned estimated factors, either individually or taken as a whole. Should the actual results differ from management's projections, the valuation could be negatively or positively affected.

When incurred, the Company capitalizes the cost of improvements that extend the useful life of property and equipment. All repair and maintenance expenditures are expensed when incurred. In addition, we capitalize leasehold improvements when certain criteria are met, including when we supervise construction and will own the improvement. Tenant improvements we own are depreciated over the life of the respective lease or the estimated useful life of the improvements, whichever is shorter.

Interest, real estate taxes, development-related salary costs 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.

*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 successful 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. In addition, deferred leasing costs include amounts attributed to in-place leases associated with acquisition properties.

*Revenue Recognition*

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

*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 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 its 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, 2010 compared to quarter ended June 30, 2009****Revenue**

(Dollars in thousands)	Quarters ended June 30,		2010 to 2009 Change	
	2010	2009	\$	%
Base rent	\$ 31,834	\$ 31,131	\$ 703	2.3%
Expense recoveries	6,928	7,048	(120)	-1.7%
Percentage rent	331	328	3	0.9%
Other	1,028	909	119	13.1%
<b>Total revenue</b>	<b>\$ 40,121</b>	<b>\$ 39,416</b>	<b>\$ 705</b>	<b>1.8%</b>

**Note:** (Dollars in thousands)

Base rent includes \$156 and \$282 for the quarters ended June 30, 2010 and 2009, respectively, to recognize base rent on a straight-line basis. In addition, base rent includes \$267 and \$308, for the quarters ended June 30, 2010 and 2009, respectively, to recognize income from the amortization of in-place leases acquired in connection with purchased real estate investment properties.

Total revenue increased 1.8% in the quarter ended June 30, 2010 ( 2010 Quarter ) compared to the corresponding prior year's quarter ( 2009 Quarter ). The revenue increase for the 2010 Quarter resulted from increased base rental income primarily at Seven Corners and White Oak due primarily to the commencement of rent in the third quarter of 2009 from new anchor tenant leases (approximately \$346,000) and from two recently developed properties that were not fully operational during the 2009 Quarter (approximately \$326,000). These two properties (Northrock and Westview Village) are defined as the Development Properties . A discussion of the components of revenue follows.

*Base rent.* The increase in base rent for the 2010 Quarter versus the 2009 Quarter resulted primarily from Seven Corners and White Oak, where rental income commenced at each property from a new anchor tenant during the third quarter of 2009 (approximately \$346,000) and new leases in effect at the Development Properties (approximately \$326,000). To a lesser extent, base rent increased at the remainder of the portfolio properties (approximately \$31,000).

*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 primary cause for the decrease in expense recovery income in the 2010 Quarter was a \$305,000 decrease in real estate tax recovery income at four Northern Virginia shopping centers and 601 Pennsylvania Avenue, substantially as a result of declines in real estate tax expense.

*Percentage rent.* Percentage rent is rental revenue calculated on the portion of a tenant's sales revenue that exceeds a specified breakpoint.

*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. The increase in other revenue for the 2010 Quarter resulted primarily from increased parking income in the office properties (approximately \$58,000).

### *Operating Expenses*

(Dollars in thousands)	Quarters ended June 30,		2010 to 2009 Change	
	2010	2009	\$	%
Property operating expenses	\$ 4,902	\$ 4,845	\$ 57	1.2%
Provision for credit losses	157	232	(75)	-32.3%
Real estate taxes	4,452	4,620	(168)	-3.6%
Interest expense and amortization of deferred debt costs	8,887	8,782	105	1.2%
Depreciation and amortization of leasing costs	7,317	7,083	234	3.3%
General and administrative	3,689	3,280	409	12.5%
<b>Total operating expenses</b>	<b>\$ 29,404</b>	<b>\$ 28,842</b>	<b>\$ 562</b>	<b>1.9%</b>

*Property operating expenses.* Property operating expenses consist of repairs and maintenance, utilities, payroll, insurance and other property related expenses.

*Provision for credit losses.* The provision for credit losses represents the Company's estimation of amounts previously included in income and owed by tenants that may not be collectible. The quarterly provisions for credit losses represent approximately four tenths and six tenths of one percent (0.4% and 0.6%) of total revenue for 2010 Quarter and 2009 Quarter, respectively.

*Real estate taxes.* The decrease in real estate taxes for the 2010 Quarter was primarily due to a \$246,000 decrease in core property real estate tax expense compared to the 2009 Quarter's amount, impacted largely by decreased taxes at several of the Company's Northern Virginia shopping centers and 601 Pennsylvania Avenue, offset in part by real estate tax expense at the Development Properties (approximately \$78,000).

*Interest expense and amortization of deferred debt.* Interest expense increased in the 2010 Quarter versus the 2009 Quarter primarily due to approximately \$45,000,000 of increased debt balances outstanding, resulting from the refinancing of five mortgage loans during 2009 and construction loan draws, less scheduled monthly principal payments. The majority of the interest incurred on the construction loans was capitalized as project costs and had little impact on interest expense for the 2010 Quarter. The additional amounts borrowed increased interest expense in the 2010 Quarter compared to the 2009 Quarter by approximately \$725,000, which was partially offset approximately \$285,000 by lower interest rates and a \$280,000 revolving credit facility modification fee incurred during the 2009 Quarter.

*General and administrative.* General and administrative expenses consist of payroll, administrative and other overhead expenses. The majority of the general and administrative expense increase during the 2010 Quarter resulted from increased payroll related expenses, professional fees and directors' option expense.

**Six Months ended June 30, 2010 compared to Six Months ended June 30, 2009**

**Revenue**

(Dollars in thousands)	Six Months ended June 30,		2010 to 2009 Change	
	2010	2009	\$	%
Base rent	\$ 63,529	\$ 61,796	\$ 1,733	2.8%
Expense recoveries	15,655	14,628	1,027	7.0%
Percentage rent	689	561	128	22.8%
Other	3,896	2,120	1,776	83.8%
<b>Total revenue</b>	<b>\$ 83,769</b>	<b>\$ 79,105</b>	<b>\$ 4,664</b>	<b>5.9%</b>

**Note:** (Dollars in thousands)

Base rent includes \$270 and \$240 for the six month periods ended June 30, 2010 and 2009, respectively, to recognize base rent on a straight-line basis. In addition, base rent includes \$545 and \$655, for the six month periods ended June 30, 2010 and 2009, respectively, to recognize income from the amortization of in-place leases acquired in connection with purchased real estate investment properties.

Total revenue increased 5.9% in the six month period ended June 30, 2010 ( 2010 Period ) compared to the corresponding prior year's period ( 2009 Period ). The revenue increase for the 2010 Period resulted from the collection of past due rents and other damages arising from a long-standing dispute with a tenant over the non-payment of rent over a period of time (approximately \$1,939,000), expense recovery income resulting from substantial snow removal expenses incurred during the 2010 Period (approximately \$1,200,000), increased base rent from core properties (approximately \$973,000) and rental income from the Development Properties (approximately \$965,000). A discussion of the components of revenue follows.

*Base rent.* The increase in base rent for the 2010 Period versus the 2009 Period resulted primarily from new leases in effect at the Development Properties (approximately \$760,000), Seven Corners and White Oak where rental income commenced from a new anchor tenant at each property during the third quarter of 2009 (approximately \$723,000) and 601 Pennsylvania Avenue where space rolled-over at a higher rental rates (approximately \$476,000).

*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 primary cause for the increase in expense recovery income in the 2010 Period was approximately \$1,200,000 recovery of snow removal expenses incurred as a result of severe winter weather impacting the Mid-Atlantic states during February 2010.



*Percentage rent.* Percentage rent is rental revenue calculated on the portion of a tenant's sales revenue that exceeds a specified breakpoint. The primary reason for the 2010 Period increase was timing differences in the receipt of sales reports used to calculate percentage rent from two retail tenants.

*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. The increase in other revenue for the 2010 Period resulted primarily from the collection of past due rents and other damages arising from a long-standing dispute with a tenant over the non-payment of rent over a period of time (approximately \$1,939,000) offset in part by decreased lease termination fees resulting from \$321,000 received from a former tenant at Avenel Business Park in the 2009 Period.

**Operating Expenses**

(Dollars in thousands)	Six months ended June 30,		2010 to 2009 Change	
	2010	2009	\$	%
Property operating expenses	\$ 12,581	\$ 10,215	\$ 2,366	23.2%
Provision for credit losses	354	559	(205)	-36.7%
Real estate taxes	9,137	9,036	101	1.1%
Interest expense and amortization of deferred debt costs	17,478	16,978	500	2.9%
Depreciation and amortization of leasing costs	14,390	14,124	266	1.9%
General and administrative	6,538	6,069	469	7.7%
<b>Total operating expenses</b>	<b>\$ 60,478</b>	<b>\$ 56,981</b>	<b>\$ 3,497</b>	<b>6.1%</b>

*Property operating expenses.* Property operating expenses consist of repairs and maintenance, utilities, payroll, insurance and other property related expenses. Property operating expenses for the 2010 Period increased primarily from a \$2,406,000 increase in snow removal expense arising primarily from the February 2010 snow storms impacting the Mid-Atlantic states.

*Provision for credit losses.* The provision for credit losses represents the Company's estimation of amounts previously included in income and owed by tenants that may not be collectible. The provisions for credit losses represent approximately four tenths and seven tenths of one percent (0.4% and 0.7%) of total revenue for the 2010 Period and 2009 Period, respectively.

*Real estate taxes.* The increase in real estate taxes for the 2010 Period is due to the Development Properties.

*Interest expense and amortization of deferred debt.* Interest expense increased in the 2010 Period versus the 2009 Period primarily due to approximately \$52,000,000 of increased debt

balances outstanding, resulting from the refinancing of five mortgage loans during 2009 and construction loan draws, less scheduled monthly principal payments. The majority of the interest incurred on the construction loans was capitalized as project costs and had little impact on interest expense for the 2010 Period. The additional amounts borrowed increased interest expense in the 2010 Period compared to the 2009 Period by approximately \$1,680,000, which was partially offset approximately \$435,000 by lower interest rates, increased capitalized interest of approximately \$550,000 and a \$280,000 revolving credit facility modification fee incurred during the 2010 Period.

*General and administrative.* General and administrative expenses consist of payroll, administrative and other overhead expenses. The majority of the general and administrative expense increase during the 2010 Period resulted from increased payroll related expenses and professional expenses.

Loss on Early Extinguishment of Debt. In June 2010, the Company refinanced its Thruway shopping center, located in Winston-Salem, North Carolina. The new \$45,600,000 loan requires principal and interest payments calculated using a 5.83% interest rate and a 25-year amortization schedule, and matures in ten years. This loan refinanced a portion of a 7.67%, multi-property loan scheduled to mature in October 2012. In conjunction with the refinancing, the Company incurred early extinguishment of debt costs totaling \$4,479,000 (approximately \$4,425,000 to defease the original loan and write-offs of unamortized deferred debt costs of approximately \$54,000). The transaction substantially reduced the Company's refinancing risk by decreasing the amount of debt maturing in 2012 from \$98,300,000 to \$69,000,000, and provided net cash proceeds of approximately \$10,500,000.

During the 2009 Period, the Company refinanced debt with outstanding balances totaling \$48,059,000, prior to its December 2011 maturity, in order to obtain new mortgage debt totaling \$85,000,000. In conjunction with the refinancings, the Company incurred prepayment penalties (approximately \$1,442,000) and wrote-off of unamortized deferred debt costs related to the repaid mortgages (approximately \$218,000).

#### Liquidity and Capital Resources

Cash and cash equivalents were \$28,829,000 and \$38,213,000 at June 30, 2010 and 2009, respectively. The Company's cash flow is affected by its operating, investing and financing activities, as described below.

(Dollars in thousands)	Six Months Ended June 30,	
	2010	2009
Net cash provided by operating activities	\$ 35,157	\$ 35,797
Net cash used in investing activities	(40,590)	(37,907)
Net cash provided by financing activities	13,655	27,317
Increase in cash and cash equivalents	\$ 8,222	\$ 25,207

*Operating Activities*

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

*Investing Activities*

Net cash used in investing activities includes property acquisitions, developments, redevelopments, tenant improvements and other property capital expenditures. Investing activities for the 2010 Period primarily reflect the development and construction costs of Clarendon Center. Investing activities for the 2009 Period primarily reflect the development and construction costs of Clarendon Center, Northrock and Westview Village. Tenant improvement and property capital expenditures totaled \$2,229,000 and \$4,548,000, for the 2010 and 2009 six-month periods, respectively.

*Financing Activities*

Net cash provided by financing activities for the six months ended June 30, 2010 primarily reflects:

proceeds of \$45,600,000 received from mortgage notes payable;

proceeds of \$22,884,000 received from construction loan draws; and

proceeds of \$7,975,000 from the issuance of common stock under the dividend reinvestment program and the exercise of stock options;

which was partially offset by:

the repayment of mortgage notes payable totaling \$38,049,000;

distributions to common stockholders totaling \$13,012,000;

distributions to holders of convertible limited partnership units in the Operating Partnership totaling \$3,899,000;

distributions made to preferred stockholders totaling \$7,570,000; and

payments of \$274,000 for financing costs of mortgage notes payable.

Net cash provided by financing activities for the six months ended June 30, 2009 primarily reflects:

proceeds of \$86,882,000 received from mortgage notes payable;

proceeds of \$30,000,000 received from advances under the revolving credit facility;



proceeds of \$13,499,000 received from construction loan draws; and

proceeds of \$470,000 received from the issuance of common stock under the dividend reinvestment program; which was partially offset by:

the repayment of mortgage notes payable totaling \$61,620,000;

repayments of amounts borrowed on the revolving credit facility totaling \$15,000,000;

distributions to common stockholders totaling \$13,937,000;

distributions to holders of convertible limited partnership units in the Operating Partnership totaling \$4,224,000;

distributions made to preferred stockholders totaling \$7,570,000; and

payments of \$1,183,000 for financing costs of mortgage notes payable.

***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 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, available cash and its existing line of credit.

Long-term liquidity requirements consist primarily of obligations under our long-term debt and dividends paid to our preferred shareholders. We anticipate that long-term liquidity requirements will also include amounts required for property acquisitions and developments. During the remainder of the year, the Company will continue to develop its construction in progress properties and may develop certain freestanding outparcels within certain of the Shopping Centers. Although not currently planned, it is possible that the Company may redevelop certain of the Current Portfolio Properties and may develop expansions within certain of the Shopping Centers.

Acquisition and development of properties are undertaken only after careful analysis and review, and management's determination that such properties are expected to provide long-term earnings and cash flow growth. During the coming year, developments, expansions or acquisitions (if any) are expected to be funded with available cash, bank borrowings from the

Company's credit line, construction and permanent financing, proceeds from the operation of the Company's dividend reinvestment plan or other external debt or equity capital resources available to the Company. 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, 2010, the scheduled maturities, including scheduled principal amortization, of all debt for years ended December 31, are as follows:

***Debt Maturity Schedule***

(Dollars in thousands)	Balloon Payments	Scheduled Principal Amortization	Total
July 1 through December 31, 2010	\$	\$ 6,645	\$ 6,645
2011	83,621 <sup>(a)</sup>	17,676	101,297
2012	69,014	16,542	85,556
2013	39,629	12,174	51,803
2014	13,218	12,327	25,545
2015	15,074	12,473	27,547
Thereafter	288,587	80,261	368,848
	\$ 509,143	\$ 158,098	\$ 667,241

(a) Represents the Clarendon Center and Northrock construction loan balances as of June 30, 2010, both of which may be extended upon achievement of certain construction and/or leasing requirements.

Management believes that the Company's capital resources, which at June 30, 2010 included cash balances of approximately \$28,829,000 and borrowing availability of approximately \$149,823,000 on its unsecured revolving credit facility, will be sufficient to meet its liquidity needs for the foreseeable future.

***Dividend Reinvestments***

In December 1995, the Company established a Dividend Reinvestment and Stock Purchase Plan (the "DRIP") 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 DRIP 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 DRIP are paid by the Company. The Company issued 199,695 and 9,416 shares under the DRIP at a weighted average discounted price of \$36.86 and \$31.86 per share, during the six month periods ended June 30, 2010 and 2009, respectively. The Company also credited 4,366 and 5,396 shares to directors

pursuant to the reinvestment of dividends specified by the Directors' Deferred Compensation Plan at a weighted average discounted price of \$36.70 and \$31.88 per share, during the six month periods ended June 30, 2010 and 2009, respectively.

### ***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, 2010.

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 strategy in light of current economic conditions, relative costs of capital, market values of the Company's 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 strategy 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 strategy 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, consistent with its long-term plans.

The Company maintains an unsecured revolving credit facility. The facility provides working capital and funds for acquisitions, certain developments and redevelopments, expires on June 30, 2012, 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. As of June 30, 2010, of the \$150,000,000 available for borrowing, there were no outstanding borrowings, approximately \$177,000 was committed for letters of credit and approximately \$149,823,000 was available to borrow for working capital, operating property acquisitions or development projects. The interest rate under the facility is determined primarily based on the level of operating income generated by the Company's existing unencumbered properties and, to a lesser extent, certain leverage tests. As of June 30, 2010, operating income from the unencumbered properties determined the interest rate for up to \$105,000,000 of the line's available borrowings, with interest expense to be calculated based upon LIBOR plus a spread of 3.65% to 3.90%. The interest rate on the remaining \$45,000,000 of the line's availability is determined based upon the Company's consolidated operating income after debt service. On this portion of the facility, interest accrues at a rate of LIBOR plus a spread of 4.45% to 5.25%, determined by certain leverage tests. The Company may elect to use the 1, 2, 3 or 6 month LIBOR, but in no event shall LIBOR be less than 1.5%.

The facility requires the Company and its subsidiaries to maintain certain financial covenants. As of June 30, 2010, 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 \$600 million plus 90% of the Company's future net equity proceeds;

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 2.2x on a trailing 12-full calendar month basis (interest expense coverage);

limit the amount of debt so that interest and scheduled principal amortization coverage exceeds 1.6x (debt service coverage);

limit the amount of debt so that interest, scheduled principal amortization and preferred dividend coverage exceeds 1.4x (fixed charge coverage); and

limit the amount of variable rate debt and debt with initial loan terms of less than five years to no more than 40% of total debt. As of June 30, 2010, the Company was in compliance with all such covenants.

Saul Centers is a guarantor of the revolving credit facility, of which the Operating Partnership is the borrower. Saul Centers is also the guarantor of 50% of the Northrock construction loan (approximately \$9,705,000 of the \$19,409,000 outstanding at June 30, 2010) and the Clarendon Center construction loan (approximately \$64,212,000 outstanding at June 30, 2010). The fixed-rate notes payable are all non-recourse debt except for \$3,882,000 of the Great Falls Center mortgage, which is guaranteed by Saul Centers.

On June 29, 2010, the Company closed on a new 10-year mortgage loan in the amount of \$45,600,000, secured by Thruway. The loan matures July 1, 2020, bears interest at a variable rate equal to the sum of one-month LIBOR and 260 basis points, requires equal monthly principal and interest payments of \$289,081, based upon an assumed interest rate of 5.83% and a 25-year principal amortization, and requires a final principal payment of approximately \$34,753,000 at maturity. In conjunction with the financing, the Company entered into an interest rate swap agreement with a \$45,600,000 notional amount to manage the interest rate risk associated with the above \$45,600,000 of variable-rate mortgage debt. The swap agreement was effective June 29, 2010, terminates on July 1, 2020 and effectively fixes the interest rate on the mortgage debt at 5.83%. We have designated this agreement as a cash flow hedge for accounting purposes. The critical terms of the interest rate swap match the terms of the variable-rate mortgage debt and, as a result, the hedge has been deemed to be perfectly effective and the arrangement satisfies the criteria for the so-called short-cut method of accounting. The Company, therefore, will recognize interest expense on the variable-rate debt at the effective fixed rate of 5.83% and will not test the hedge for effectiveness in future periods.

Prior to the refinancing, Thruway was one of nine properties securing a collateralized mortgage-backed security (CMBS) with an outstanding balance of \$108,324,000, an interest rate of 7.67% and due to mature October 2012. In order to release Thruway, the Company entered into a transaction to defease \$30,179,000 of the outstanding balance at a cost of approximately \$4,425,000, using proceeds from the new mortgage financing.



In May 2010, the Company committed to borrow \$17,000,000 under a mortgage loan to refinance existing debt due to mature October 2012 and secured by Ravenwood. Subject to standard closing requirements, the loan is expected to close by December 15, 2010, will have a term of 15 years and have monthly interest and principal payments of \$111,409 based upon a fixed interest rate of 6.18% and a 25-year amortization schedule.

#### ***Preferred Stock***

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

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

#### ***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.

#### ***Funds From Operations***

For the quarter ended June 30, 2010, the Company reported Funds From Operations (FFO)<sup>(1)</sup> available to common shareholders of \$9,770,000, representing a 20.0% decrease over the comparative 2009 quarter's FFO available to common shareholders. For the six months ended June 30, 2010, the Company reported FFO available to common shareholders of \$25,632,000, representing a 5.1% decrease over the comparative 2009 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**

(Amounts in thousands)	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net income	\$ 6,238	\$ 8,914	\$ 18,812	\$ 20,464
Add:				
Real estate depreciation & amortization	7,317	7,083	14,390	14,124
FFO	13,555	15,997	33,202	34,588
Subtract:				
Preferred stock dividends	(3,785)	(3,785)	(7,570)	(7,570)
FFO available to common shareholders	\$ 9,770	\$ 12,212	\$ 25,632	\$ 27,018
Average shares & units used to compute FFO per share	23,728	23,333	23,655	23,324

- (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 real estate depreciation and amortization, and excluding extraordinary items and gains or losses from property dispositions. 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**

During the remainder of the year the Company will continue to develop its construction in progress properties and may develop certain freestanding outparcels within certain of the Shopping Centers. Although not currently planned, it is possible that the Company may redevelop certain of the Current Portfolio Properties and may develop expansions within certain of the Shopping Centers. Acquisition and development of properties are undertaken only after careful analysis and review, and management's determination that such properties are expected to provide long-term earnings and cash flow growth. During the balance of the 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 analyze redevelopment, renovation and expansion opportunities within the portfolio. The following describes the acquisition, development, redevelopment and renovation activities of the Company in 2009 and the six months ended June 30, 2010.

As of June 30, 2010, the 26.0 acre Lexington Center land parcel and the 13,646 square feet of Lexington pads were under contract to be sold, subject to customary due diligence, for approximately \$8 million, which is in excess of their \$4.5 million carrying value. The sale is expected to close no later than the 1<sup>st</sup> quarter of 2011. There is no debt associated with the properties as of June 30, 2010.

*Ashland Square Phase I*

On December 15, 2004, the Company purchased for \$6.3 million, a 19.3 acre parcel of land in Manassas, Prince William County, Virginia. The Company received site plan approval during the third quarter of 2006 to develop a grocery-anchored neighborhood shopping center totaling approximately 125,000 square feet of retail space. A site plan for an additional 35,000 square feet of commercial space is under review by Prince William County. During the fourth quarter of 2007, the Company completed preliminary site work consisting of clearing, grading and site utility construction. A ground lease has been executed with Chevy Chase Bank, which built a branch, on a pad site, that opened for business October 2007. During 2009, the Company executed a lease with CVS, which is subject to the tenant obtaining site plan and special use permits from Prince William County. It is uncertain whether these lease contingencies will be fulfilled as permit submissions are in progress. If successful, CVS is expected to commence operations in late 2011. The balance of the center is being marketed to grocers and other retail businesses, with a development timetable yet to be finalized.

*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. The center was acquired for a purchase price of \$17.5 million subject to the assumption of an \$11.3 million mortgage loan. The Company commenced construction during the first quarter of 2008 on a capital improvement project to improve access to the center, reconfigure portions of the center and upgrade the center's façade and common areas. The redeveloped center totals approximately 173,000 square feet. Substantial completion of construction was achieved during the second quarter of 2009 and the center was 78% leased at June 30, 2010. Project costs totaled approximately \$6.9 million.

*Clarendon Center*

The Company is constructing a mixed-use development project to include approximately 42,000 square feet of retail space, 170,000 square feet of office space and 244 residential units adjacent to the Clarendon Metro Station in Arlington, Virginia. The total development costs are expected to be approximately \$195.0 million, a portion of which will be funded with the \$157.5 million construction loan that the Company closed in May 2008. Construction of south block's exterior surfaces is nearly complete. Interior finish work and installation of appliances is continuing. Exterior wall brick laying and window installation in the north block's six-story office building is nearly completed. The Company estimates construction on both blocks will be substantially complete in late 2010, at which time the residential component is expected to be operational and ready for occupancy. The retail and office spaces will be operational as tenant improvements are built-out. The Company has executed seven leases for retail space totaling 18,760 square feet and three office leases totaling 83,716 square feet (of which approximately 10,000 square feet will be leased to an adjacent property owner for a rent equal to only the tenant's prorated share of expenses in exchange for that property owner's prior conveyance of development rights which increased the project's size).

*Westview Village*

In November 2007, the Company purchased for \$5.0 million, a 10.4 acre site in the Westview development on Buckeystown Pike (MD Route 85) in Frederick, Maryland. Construction was substantially completed in the second quarter of 2009 on a development that totals approximately 101,000 square feet of commercial space, including 60,000 square feet of retail shop space, 11,000 square feet of retail pads and 30,000 square feet of professional office space and is expected to cost approximately \$26.5 million. The Company is currently marketing the space and as of June 30, 2010, has executed leases for 29,850 square feet of retail and 1,200 square feet of office space, or approximately 30.7% of the total space.

*Northrock*

In January 2008, the Company purchased for \$12.5 million, approximately 15.4 acres of undeveloped land in Warrenton, Virginia, located at the southwest corner of the U. S. Route 29/211 and Fletcher Drive intersection. The Company constructed Northrock shopping center, a neighborhood shopping center totaling approximately 103,000 square feet of leasable area. Approximately 72.3% of the project is leased at June 30, 2010, including a 52,700 square foot Harris Teeter supermarket store, 13,192 square feet of small shop space, and pad leases with Chevy Chase Bank and Longhorn Steakhouse. The Chevy Chase Bank opened February 2009. The Longhorn Steakhouse restaurant opened for business in July 2010. Total construction and development costs, including land, lease-up and tenant improvement costs, are projected to be approximately \$27.9 million, the majority of which were funded with the \$21.8 million construction loan the Company closed in May 2008. Substantial completion of construction was achieved during the first quarter of 2009.

*Boulevard*

During the second quarter of 2008, permits were issued for the redevelopment of a portion of the Boulevard shopping center. A vacant pad building previously occupied by a furniture store was demolished, the center's in-line shop space was expanded by approximately 8,000 square feet for small shop retail and a Chevy Chase Bank pad building was constructed and commenced operations. As of June 30, 2010, all six shop spaces and the bank pad were leased, totaling 11,610 square feet. Substantial completion of construction was achieved during the first quarter of 2009, and total construction and development costs were approximately \$2.8 million.

**Portfolio Leasing Status**

The following chart sets forth certain information regarding the operating portfolio for the periods ended June 30, 2010 and 2009, respectively.

As of June 30,	Total Properties		Total Square Footage		Percent Leased	
	Shopping Centers	Office	Shopping Centers	Office	Shopping Centers	Office
2010	47	5	7,218,000	1,206,000	92.2%	89.9%
2009	47	5	7,199,000	1,206,000	91.9%	91.2%

On a same property basis, 92.9% of the portfolio was leased, compared to the prior year level of 93.1%. The 2010 leasing percentages decreased due to a net decrease of approximately 17,000 square feet of leased space.

**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 may, where appropriate, employ derivative instruments, such as interest rate swaps, to mitigate the risk of interest rate fluctuations. The Company does not enter into derivatives or other financial instruments for trading or speculative purposes. On June 29, 2010, the Company entered into an interest rate swap agreement with a \$45,600,000 notional amount to manage the interest rate risk associated with \$45,600,000 of variable-rate mortgage debt. The swap agreement was effective July 1, 2010, terminates on July 1, 2020 and effectively fixes the interest rate on the mortgage debt at 5.83%. The fair value of the swap agreement was not material as of June 30, 2010.

The Company is exposed to interest rate fluctuations which will affect the amount of interest expense of its variable rate debt and the fair value of its fixed rate debt. As of June 30, 2010, the Company had variable-rate indebtedness totaling \$83,621,000. If the interest rates on the Company's variable rate debt instruments outstanding at June 30, 2010 had been one percent higher, our annual interest incurred relating to these debt instruments would have increased by \$836,210, based on those balances. As of June 30, 2010, the Company had fixed-rate indebtedness totaling \$583,620,000 with a weighted average interest rate of 6.54%. If interest rates on the Company's fixed-rate debt instruments at June 30, 2010 had been one percent higher, the fair value of those debt instruments on that date would have decreased by approximately \$31,909,000.

**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 Senior Vice President-Chief Accounting Officer as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of 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 Senior 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, 2010. Based on the foregoing, the Company's Chairman and Chief Executive Officer, its Senior Vice President-Chief Financial Officer, Secretary and Treasurer and its Senior 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, 2010.

During the quarter ended June 30, 2010, 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 the risk factors presented in Item 1A. Risk Factors in the 2009 Annual Report of the Company on Form 10-K.

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

B. Francis Saul II, the Company's Chairman of the Board and Chief Executive Officer, his spouse and entities affiliated with Mr. Saul II, through participation in the Company's Dividend Reinvestment and Stock Purchase Plan for the April 30, 2010 dividend distribution acquired 85,759 shares of common stock at a price of \$33.08 per share. In addition, B. F. Saul Real Estate Investment Trust, an entity affiliated with B. Francis Saul II, acquired the following shares in open market purchases:

<b>Period</b>	<b>Total Shares Purchased</b>	<b>Average Price Paid Per Share</b>
April 1-9, 2010	24,772	\$ 41.71
May 6-28, 2010	264,900	38.54
June 1-30, 2010	457,859	40.54
Total	747,531	\$ 39.87

None of such shares were acquired pursuant to a publicly announced plan or program.

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Reserved****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. Amendment No. 1 to Amended and Restate Bylaws of Saul Centers, Inc. adopted November 29, 2007 and filed as Exhibit 3(b) of the Company's Current Report on Form 8-K filed December 3, 2007 is hereby incorporated by reference.
  - (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.
  - (d) Articles Supplementary to First Amended and Restated Articles of Incorporation of the Company, as amended, dated March 26, 2008, filed as Exhibit 3.1 to the Company's Current Report on Form 8-K, filed March 27, 2008, 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) Deposit Agreement, dated March 27, 2008, among the Company, Continental Stock Transfer & Trust Company, as Depositary, and the holders of depositary receipts, each representing 1/100th of a share of 9% Series B Cumulative Redeemable Preferred Stock of Saul Centers, Inc. and filed as Exhibit 4.1 to the Registration Statement on Form 8-A on March 27, 2008 is hereby incorporated by reference.
- (c) 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.
- (d) Form specimen of receipt representing the depositary shares, each representing 1/100th of a share of 9% Series B Cumulative Redeemable Preferred Stock of Saul Centers, Inc. and included as part of Exhibit 4.2 to the Registration Statement on Form 8-A on March 27, 2008 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. The Eighth 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, 2007 Annual Report of the Company on Form 10-K is hereby incorporated by reference. The Ninth 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, 2008 Quarterly Report of the Company on Form 10-Q is hereby incorporated by reference. The Tenth 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, 2008 Quarterly Report of the Company on Form 10-Q is hereby incorporated by reference.

- (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. The Fourth 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 2009 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) Revolving Credit Agreement, dated as of December 19, 2007, 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, and Sovereign Bank, as Lenders, as filed as Exhibit 10.(n) of the December 31, 2007 Annual Report of the Company on Form 10-K, is hereby incorporated by reference. Modification to Revolving Credit Agreement, dated April 30, 2009, as filed as Exhibit 10.(l) of the June 30, 2009 Quarterly Report of the Company, is hereby incorporated by reference. Second Modification to Revolving Credit Agreement, dated July 9, 2009, as filed as Exhibit 10.(l) of the June 30, 2009 Quarterly Report of the Company, is hereby incorporated by reference. Third Modification to Revolving Credit Agreement, dated July 28, 2009, as filed as Exhibit 10.(l) of the June 30, 2009 Quarterly Report of the Company, is hereby incorporated by reference.

- (k) Guaranty, dated as of December 19, 2007, 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.(o) of the December 31, 2007 Annual Report of the Company on Form 10-K, is hereby incorporated by reference.
  - (l) 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. The Amendment to Saul Centers, Inc. 2004 Stock Plan, as filed as Annex A to the Proxy Statement of the Company for its 2008 Annual Meeting of Stockholders, is hereby incorporated by reference.
  - (m) 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.
  - (n) 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.
  - (o) Construction Loan Agreement, dated as of May 14, 2008, by and among Saul Holdings Limited Partnership, U.S. Bank National Association, as agent, and the lenders party to or who become party to such agreement, as filed as Exhibit 10.(a) of the Company's Current Report on Form 8-K dated May 20, 2008, is hereby incorporated by reference.
  - (p) Shared Services Agreement, dated as of July 1, 2004, between B. F. Saul Company and Saul Centers, Inc., as filed as Exhibit 10.(a) of the Company's Current Report on Form 8-K dated October 3, 2008, 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 (filed herewith).

**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 4, 2010

/s/ B. FRANCIS SAUL III  
**B. Francis Saul III, President**

Date: August 4, 2010

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

Date: August 4, 2010

/s/ JOEL A. FRIEDMAN  
**Joel A. Friedman**  
**Senior Vice President, Chief Accounting Officer**  
**(principal accounting officer)**