

Saul Centers



2012 ANNUAL REPORT to shareholders



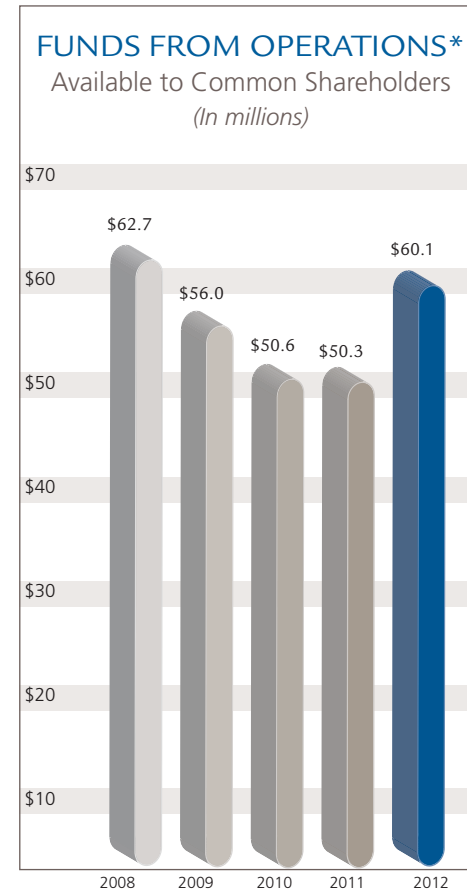
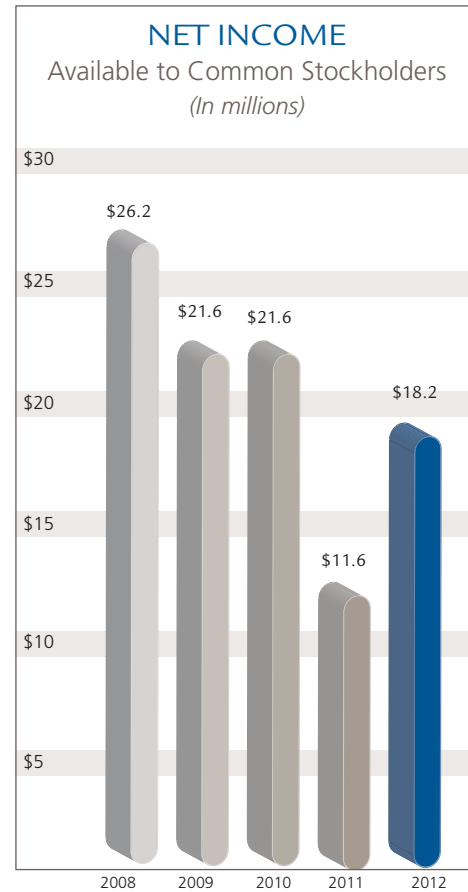
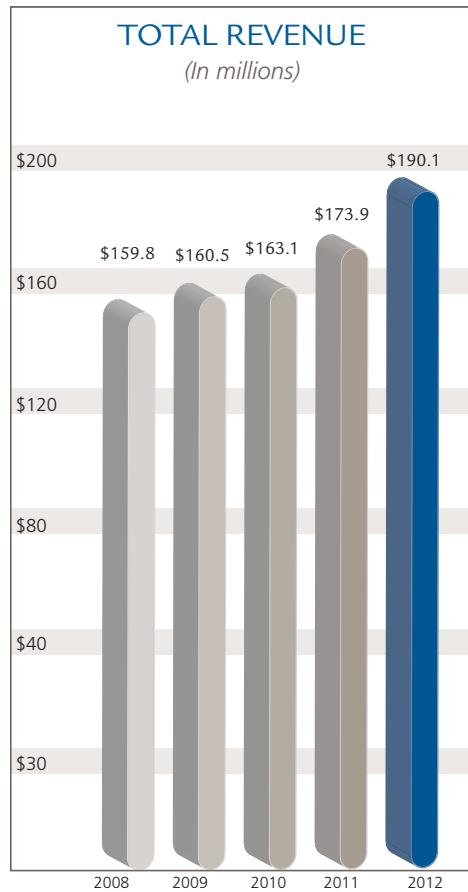
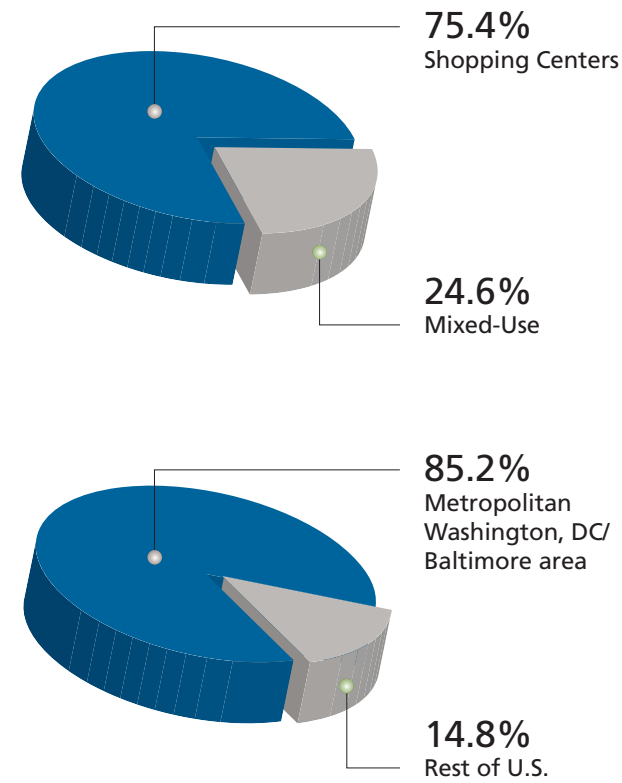
SAUL CENTERS, INC.

is a self-managed, self-administered equity real estate investment trust headquartered in Bethesda, Maryland. Saul Centers operates and manages a real estate portfolio of 59 community and neighborhood shopping centers, 7 mixed-use properties and 2 land parcels totaling approximately 9.5 million square feet of leasable area. Over 85% of the property operating income is generated from properties in the metropolitan Washington, DC/ Baltimore area.

Saul Centers' primary operating strategy is to focus on continuing its program of internal growth, renovations, and expansions of community and neighborhood shopping centers that primarily serve the day-to-day necessities and services sub-sector of the overall retail market. The Company plans to supplement its growth through effective development of new retail and mixed-use properties, and acquisitions of operating properties as appropriate opportunities arise.

PORTFOLIO COMPOSITION

Based on 2012 Property Operating Income



* Funds From Operations (FFO) is a non-GAAP financial measure. See page 24 for a definition of FFO and reconciliation from Net Income.

	Year ended December 31,				
	2012	2011	2010	2009	2008
Summary Financial Data					
Total Revenue	\$190,092,000	\$173,878,000	\$163,108,000	\$160,539,000	\$159,775,000
Net Income Available to Common Stockholders	\$18,234,000	\$11,593,000	\$21,623,000	\$21,573,000	\$26,241,000
FFO Available to Common Shareholders	\$60,100,000	\$50,309,000	\$50,556,000	\$56,025,000	\$62,695,000
Weighted Average Common Stock Outstanding	19,700,000	18,949,000	18,377,000	17,943,000	17,961,000
Weighted Average Shares and Units Outstanding	26,614,000	24,740,000	23,793,000	23,359,000	23,377,000
Net Income Available to Common Stockholders Per Share (Diluted)	\$0.93	\$0.61	\$1.18	\$1.20	\$1.46
FFO Available to Common Shareholders Per Share (Diluted)	\$2.26	\$2.03	\$2.12	\$2.40	\$2.68
Common Dividend as a Percentage of FFO (Per Share)	64%	71%	68%	64%	70%
Interest Expense Coverage ^a	2.68	2.61	3.20	3.27	3.33

Property Data					
Number of Operating Properties ^b	57	58	55	52	50
Total Portfolio Square Feet	9,489,000	9,543,000	8,901,000	8,424,000	8,194,000
Shopping Center Square Feet	7,877,000	7,933,000	7,293,000	7,218,000	6,988,000
Mixed-Use Square Feet	1,612,000	1,610,000	1,608,000	1,206,000	1,206,000
Average Percentage Leased	91% ^c	90% ^c	91%	92%	95%

(a) Interest expense coverage is defined as operating income before the sum of interest expense and amortization of deferred debt, predevelopment expenses and depreciation and amortization of deferred leasing costs, divided by interest expense.

(b) Excludes development parcels (Ashland Square Phase II and New Market).

(c) Average percentage leased excludes Clarendon Center residential which averaged 98% and 97% leased during 2012 and 2011, respectively.



MESSAGE TO SHAREHOLDERS

As a result of good tenant retention and successful leasing to new tenants, retail space was 93.4% leased at year-end 2012, the highest level during the past three years.

Improving economic factors began to have a positive impact on our retail and mixed-use property operating performance during 2012, following the downturn of the last 5 years. The national unemployment rate has improved from 9.3% in December 2010 to 7.7% in February 2013. Unemployment in the Washington, D.C. metropolitan area, as reported by the Department of Labor, also improved from 5.7% to 5.2% during these past two years. The area's housing recovery appears to have gained momentum with home sales volume and median prices both up from 2011 levels. These positive economic trends have improved consumer confidence and helped fuel increased retail sales volume.

Within our shopping center portfolio, sales volumes of tenants reporting sales increased 4.8% in 2012 to \$339 per square foot. Stronger retail demand is a primary driver of our overall property earnings, as 75% of our overall property operating income is generated from our 50 shopping centers. Over 80% of this shopping center operating income is generated from properties in the Washington, D.C./Baltimore metropolitan area.

Our shopping center tenants renewed their leases at a 70% rate in 2012, a healthy increase from the 60% renewal rate in 2011. As a result of good tenant retention and successful leasing to new tenants, retail space was 93.4% leased at year-end 2012, the highest level during the past three years. Tenant delinquent rent payments have dropped to their lowest levels since 2009.

In summary, we are cautiously optimistic for continued improvement in our core portfolio operating performance because of better economic indicators, improved tenant sales volume, solid leasing results and reduced tenant delinquent rent payments. However, our retail and mixed-use property operating fundamentals continue to be vulnerable to potential challenges in public and private sector job markets and the housing industry.

BALANCE SHEET HIGHLIGHTS

Throughout 2012, the favorable interest rate environment allowed us to reduce our average cost of debt by closing \$93 million of new long-term non-recourse property financings. At year-end 2012, fixed-rate debt comprised 94% of our \$828 million total borrowings and has a weighted maturity of 10 years. Only \$53 million of fixed-rate debt matures during the next 5 years. The fixed-rate debt weighted average interest rate decreased from 6.0% at the end of 2011 to the current 5.8%. In May 2012, we also completed a new 4-year, \$175 million line of credit, which replaced an expiring \$150 million line. The current 2.1% interest rate payable under our new credit line is nearly 3.2% lower than the previous rate.

Interest expense coverage improved to 2.7 times and leverage, as measured by debt to total capitalization, was 38% at December 31, 2012.

Currently, 24 of our 59 properties are unencumbered, and generated over 27% of our 2012 overall property operating income.

Further improving our overall cost of capital, on February 12, 2013, we closed on \$140 million of Series C perpetual preferred stock which has a coupon of 6.875%. The proceeds of this offering were used to redeem all \$79.3 million of our 9% Series B preferred shares and approximately \$60 million of our 8% Series A preferred shares. As a result of this offering, our weighted average cost of preferred equity was reduced from 8.4% to 7.1%.

Improved operating performance, a strengthened balance sheet and financing flexibility provide the capability to fund future development and redevelopment activities.

FINANCIAL RESULTS

Total revenue increased to \$190.1 million in 2012 from \$173.9 million in 2011, and operating income increased to \$36.2 million from \$34.0 million. Net income available to common stockholders was \$18.2 million in 2012 compared to \$11.6 million in 2011.

The primary sources of the revenue increase were \$9.7 million of additional revenue from three suburban Maryland grocery anchored shopping centers acquired in 2011 and \$4.9 million of additional revenue from Clarendon Center. Operating income



Improved operating performance, a strengthened balance sheet and financing flexibility provide the capability to fund future development and redevelopment activities.

increased \$2.2 million, of which the core portfolio generated \$4.1 million and the three 2011 acquisitions produced \$1.1 million, the combined impact of which was partially offset by \$2.7 million of predevelopment expenses at Van Ness Square where we intend to develop a primarily residential apartment project with complementary street-level retail space. The 2012 results also included property sale gains totaling \$4.5 million from the sale of two underperforming, unanchored shopping centers, partially offset by \$1.1 million of costs incurred for the December 2012 acquisition of two operating shopping center properties.

During 2012, overall same property revenue increased 1.0% and same property operating income increased 1.8%. Same property comparisons exclude the results of properties not in operation for the entirety of the comparable reporting periods. Shopping center same property operating income increased 2.0% and mixed-use portfolio same property operating income increased 0.6%. The same property results were adversely affected by Van Ness Square. If Van Ness Square was excluded, overall same property operating income would have increased 2.6% and mixed-use same property operating income would have increased 5.0%.

FFO available to common stockholders (after deducting preferred stock dividends) increased 19.5% to \$60.1 million (\$2.26 per diluted share) from \$50.3 million (\$2.03 per diluted share) in 2011. FFO increased primarily as a result of (a) the three shopping centers acquired in 2011 (\$4.7 million), the core portfolio (\$3.9 million), and Clarendon Center (\$1.0 million), (b) reduced acquisition costs (\$1.4 million) and (c) a change in fair value of interest rate swaps (\$1.4 million), the combined impact of which was partially offset by Van Ness Square predevelopment expenses (\$2.7 million).

ACQUISITION AND DEVELOPMENT ACTIVITY

The three shopping centers we acquired in late 2011 were a significant source of the portfolio's growth during 2012. Each of the three shopping centers is anchored by a Giant Food store. Two of the three grocery stores reported sales of over \$600 per square foot and rank in the top 10 in sales volume of our 33 grocery stores. The three centers were 96.7% leased at year end, and exclusive of the one-time acquisition costs, added \$4.7 million to 2012 FFO.

During 2012, we substantially completed leasing Clarendon Center, a mixed-use development on two blocks adjacent to the Clarendon Metro Station in Arlington, VA. At year-end 2012, the 244 apartments and 42,000 square feet of retail space were 100% leased, and the 171,000 square feet of office space was 97% leased. Clarendon Center negatively impacted earnings during the lease-up phase, but added \$1.0 million to FFO in 2012. This successful development is expected to provide further growth throughout 2013 as tenant build-out is completed and rent commences for the final office tenants.

During 2012, we positioned our Van Ness Square office/retail property for redevelopment by not renewing expiring leases and entering into early

lease termination agreements. As a result, the building's leasing percentage decreased from 67% in January 2012 to 44% in December 2012. As of March 1, 2013, we successfully executed the final tenant lease termination agreement and we anticipate that the building will be vacant in the spring of this year. We incurred \$2.7 million of redevelopment expenses related to these lease terminations in 2012 and expect to incur approximately \$3.3 million in 2013. In its place, we plan to construct a primarily residential apartment project with complementary street-level retail space. Construction documents and governmental approvals are in process, with a final development time table yet to be determined.

In December 2012, we purchased two operating shopping center properties in Montgomery County, MD for future redevelopment. The first property, 1500 Rockville Pike, which was acquired for \$23.0 million, including acquisition costs, is a 6.7 acre property with 53,000 rentable square feet located near the Twinbrook Metro Station. The second property, 5541 Nicholson Lane, which was acquired for \$12.2 million, including acquisition costs, is a 1.1 acre property with 20,000 rentable square feet located adjacent to our 11503 Rockville Pike property near the White Flint Metro Station. Although the current zoning permits us to develop 1.1 million square feet of new residential and commercial space on these two properties, we do not anticipate redeveloping them in the foreseeable future.



PROPERTY SALES

We sold two unanchored shopping centers during 2012 and recognized a combined gain on sale of \$4.5 million. In July, we sold the 77,000 square foot and 11.7% leased West Park in Oklahoma City, OK and in December, we sold the 55,000 square foot and 34.2% leased Belvedere Gardens in Baltimore, MD.

SHOPPING CENTER OPERATIONS

While the economic downturn and anchor tenant bankruptcies contributed to decreased same property operating results during 2010 and 2011, our shopping center results trended positive in 2012. Anchor tenant spaces vacated in 2011 by Borders, Superfresh, Syms and an independent grocer totaling 168,000 square feet were substantially re-tenanted during 2012. As of March 1, 2013, a total of 157,000 square feet of this space has been leased. This and other core property improved leasing activity were key drivers of the 2012 increase of 2.0% in same property operating income.

Overall leasing volume continued to be strong, with 222 new and renewal retail leases executed, totaling 1.1 million square feet of space. The 2012 leasing volume compares similarly with the prior two annual averages of 223 leases signed for 1.1 million square feet of retail space. More significantly, same property rental rate growth turned positive in 2012 for the first time since 2008 for new and renewal leases. New and renewal cash rents increased 1.6% over expiring rents on a same space basis. The renewal percentage, as measured by expiring base rent, also trended positively to 70% of tenants renewing leases, up from 60% in 2011. Overall shopping center credit loss decreased from the historic high level of \$1.86 million in 2011, to \$840,000 in 2012.

We have entered our 20th year as a publicly-traded REIT.

The improved leasing and rent collection trends were impacted by increasing retail tenant sales. On a same tenant basis, retail sales grew by 1.1% from 2011, after similarly modest 1.1% and 0.8% increases in 2011 and 2010, respectively. Same store grocery sales grew by 1.3% in 2012, after a 0.9% increase in 2011, which followed two years of declines. While these overall operating trends are encouraging, the recovery in the retail sector will continue to be impacted by conditions in the overall economy.

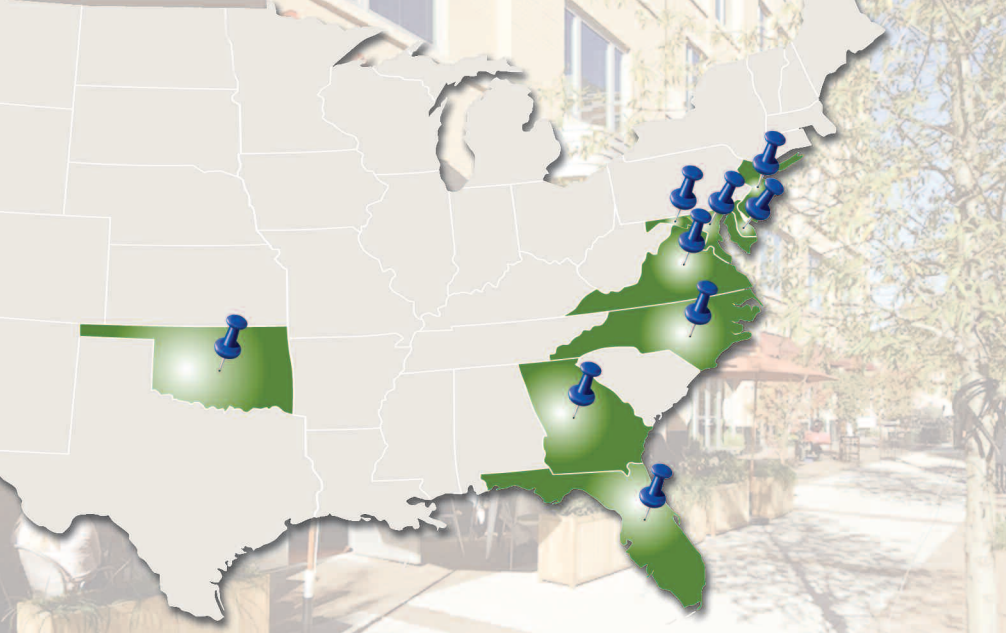
MIXED-USE RESULTS

Our 1.6 million square feet of mixed-use properties produced 24.6% of our property operating income in 2012. With the exclusion of our Van Ness Square building, which is being positioned for redevelopment, over 84% of our mixed-use property operating income is generated by three projects – our newly developed Clarendon Center in Arlington, VA, 601 Pennsylvania Avenue in Washington, DC and Washington Square in Old Town Alexandria, VA. Entering 2013, all 244 apartments at Clarendon Center and 93.9% of the 676,000 square feet of office and retail space at the three properties are leased. Despite tepid office demand in the Washington, DC metropolitan area due to the uncertainty surrounding federal government spending levels, these three properties are well positioned for the coming year with only 16,000 square feet of office leases expiring during 2013.

We have entered our 20th year as a publicly-traded REIT. In September 1993, Saul Centers was a company with \$500 million of total capitalization, operating 5.3 million square feet of rentable space in 26 properties and had a limited inventory of development opportunities. We have grown to \$2.2 billion in total capitalization, operate 9.5 million rentable square feet in 57 properties, and have over 2.3 million square feet of zoned/master planned, mixed-use redevelopment potential focused around Washington, DC metropolitan area transit centers. While our larger property base provides operational efficiencies, we are small enough to generate meaningful growth with paced development activity throughout the coming years. We remain confident that our loyal team of dedicated professionals will meet the challenges and opportunities that lie ahead, and expect to continue to deliver attractive results for our loyal investors.

For the Board

B. Francis Saul II
March 15, 2013



As of December 31, 2012, Saul Centers' portfolio properties were located in Virginia, Maryland, Washington, DC, North Carolina, Delaware, Florida, Georgia, New Jersey and Oklahoma. Properties in the metropolitan Washington, DC/ Baltimore area represent 80% of the portfolio's gross leasable area.

PORTFOLIO PROPERTIES

PROPERTY/LOCATION	GROSS LEASABLE SQUARE FEET	PROPERTY/LOCATION	GROSS LEASABLE SQUARE FEET
Shopping Centers			
ASHBURN VILLAGE, ASHBURN, VA	221,273	ORCHARD PARK, DUNWOODY, GA	87,885
ASHLAND SQUARE PHASE I, DUMFRIES, VA	23,120	PALM SPRINGS CENTER, ALTAMONTE SPRINGS, FL	126,446
BEACON CENTER, ALEXANDRIA, VA	358,015	RAVENWOOD, BALTIMORE, MD	93,328
BJ'S WHOLESALE CLUB, ALEXANDRIA, VA	115,660	11503 ROCKVILLE PK / 5541 NICHOLSON LN, ROCKVILLE, MD	40,249
BOCA VALLEY PLAZA, BOCA RATON, FL	121,269	1500 ROCKVILLE PIKE, ROCKVILLE, MD	52,681
BOULEVARD, FAIRFAX, VA	49,140	SEABREEZE PLAZA, PALM HARBOR, FL	146,673
BRIGGS CHANEY MARKETPLACE, SILVER SPRING, MD	194,347	MARKETPLACE AT SEA COLONY, BETHANY BEACH, DE	21,677
BROADLANDS VILLAGE, ASHBURN, VA	159,734	SEVEN CORNERS, FALLS CHURCH, VA	574,831
COUNTRYSIDE MARKETPLACE, STERLING, VA	141,696	SEVERNA PARK MARKETPLACE, SEVERNA PARK, MD	254,174
CRANBERRY SQUARE, WESTMINSTER, MD	141,569	SHOPS AT FAIRFAX, FAIRFAX, VA	68,762
CRUSE MARKETPLACE, CUMMING, GA	78,686	SMALLWOOD VILLAGE CENTER, WALDORF, MD	173,281
FLAGSHIP CENTER, ROCKVILLE, MD	21,500	SOUTHDALE, GLEN BURNIE, MD	484,115
FRENCH MARKET, OKLAHOMA CITY, OK	244,724	SOUTHSIDE PLAZA, RICHMOND, VA	371,761
GERMANTOWN, GERMANTOWN, MD	27,241	SOUTH DEKALB PLAZA, ATLANTA, GA	163,418
GIANT, MILFORD MILL, MD	70,040	THRUWAY, WINSTON-SALEM, NC	362,547
THE GLEN, WOODBRIDGE, VA	136,440	VILLAGE CENTER, CENTREVILLE, VA	146,309
GREAT EASTERN, DISTRICT HEIGHTS, MD	255,398	WESTVIEW VILLAGE, FREDERICK, MD	97,611
GREAT FALLS CENTER, GREAT FALLS, VA	91,666	WHITE OAK, SILVER SPRING, MD	480,676
HAMPSHIRE LANGLEY, TAKOMA PARK, MD	131,700	TOTAL SHOPPING CENTERS	7,877,159
HUNT CLUB CORNERS, APOPKA, FL	101,522	Mixed-Use Properties	
JAMESTOWN PLACE, ALTAMONTE SPRINGS, FL	96,372	AVENEL BUSINESS PARK, GAITHERSBURG, MD	390,683
KENTLANDS SQUARE I, GAITHERSBURG, MD	114,381	CLARENDON CENTER – NORTH, ARLINGTON, VA	108,387
KENTLANDS SQUARE II, GAITHERSBURG, MD	240,683	CLARENDON CENTER – SOUTH, ARLINGTON, VA	293,565
KENTLANDS PLACE, GAITHERSBURG, MD	40,648	(INCLUDES 244 APARTMENTS AT 188,671 SQUARE FEET)	
LANSDOWNE TOWN CENTER, LEESBURG, VA	189,352	CROSSTOWN BUSINESS CENTER, TULSA, OK	197,127
LEESBURG PIKE PLAZA, BAILEYS CROSSROADS, VA	97,752	601 PENNSYLVANIA AVE., WASHINGTON, DC	226,604
LUMBERTON PLAZA, LUMBERTON, NJ	193,044	VAN NESS SQUARE, WASHINGTON, DC	159,411
METRO PIKE CENTER, ROCKVILLE, MD	67,488	WASHINGTON SQUARE, ALEXANDRIA, VA	236,376
SHOPS AT MONOCACY, FREDERICK, MD	109,144	TOTAL MIXED-USE PROPERTIES	1,612,153
NORTHROCK, WARRENTON, VA	99,789	TOTAL PORTFOLIO	9,489,312
OLDE FORTE VILLAGE, FT. WASHINGTON, MD	143,577		
OLNEY, OLNEY, MD	53,765		

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SELECTED FINANCIAL DATA

<i>(In thousands, except per share data)</i>	Years Ended December 31,				
	2012	2011	2010	2009	2008
Operating Data:					
Total revenue	\$ 190,092	\$ 173,878	\$ 163,108	\$ 160,539	\$ 159,775
Total operating expenses	153,867	139,908	119,121	115,177	113,149
Operating income	36,225	33,970	43,987	45,362	46,626
Non-operating income:					
Acquisition related costs	(1,129)	(2,534)	(1,179)	-	-
Change in fair value of derivatives	36	(1,332)	-	-	-
Loss on early extinguishment of debt	-	-	(5,405)	(2,210)	-
Gain on casualty settlements	219	245	2,475	329	1,301
Discontinued operations	4,429	(55)	3,307	(251)	(261)
Net income	39,780	30,294	43,185	43,230	47,666
Income attributable to the noncontrolling interest	(6,406)	(3,561)	(6,422)	(6,517)	(7,972)
Net income attributable to Saul Centers, Inc.	33,374	26,733	36,763	36,713	39,694
Preferred dividends	(15,140)	(15,140)	(15,140)	(15,140)	(13,453)
Net income available to common stockholders	\$ 18,234	\$ 11,593	\$ 21,623	\$ 21,573	\$ 26,241
Per Share Data (diluted):					
Net income available to common stockholders	\$ 0.93	\$ 0.61	\$ 1.18	\$ 1.20	\$ 1.46
Basic and diluted shares outstanding:					
Weighted average common shares - basic	19,649	18,888	18,267	17,904	17,816
Effect of dilutive options	51	61	110	39	145
Weighted average common shares - diluted	19,700	18,949	18,377	17,943	17,961
Weighted average convertible limited partnership units	6,914	5,791	5,416	5,416	5,416
Weighted average common shares and fully converted limited partnership units - diluted	26,614	24,740	23,793	23,359	23,377
Dividends Paid:					
Cash dividends to common stockholders ⁽¹⁾	28,134	\$ 27,062	\$ 26,186	\$ 27,358	\$ 33,450
Cash dividends per share	\$ 1.44	\$ 1.44	\$ 1.44	\$ 1.50	\$ 1.88
Balance Sheet Data:					
Real estate investments (net of accumulated depreciation)	\$ 1,112,763	\$ 1,091,448	\$ 927,250	\$ 834,914	\$ 774,718
Total assets	1,207,309	1,192,569	1,013,888	925,574	853,873
Total debt, including accrued interest	831,121	835,459	713,997	639,405	570,184
Preferred stock	179,328	179,328	179,328	179,328	179,328
Total stockholders' equity	307,289	293,206	239,813	226,063	227,887
Other Data:					
Cash flow provided by (used in):					
Operating activities	\$ 78,423	\$ 55,669	\$ 62,887	\$ 68,344	\$ 73,101
Investing activities	\$ (46,873)	\$ (201,500)	\$ (98,239)	\$ (80,469)	\$ (115,070)
Financing activities	\$ (31,740)	\$ 145,186	\$ 27,713	\$ 19,726	\$ 49,210
Funds from operations ⁽²⁾ :					
Net income	\$ 39,780	\$ 30,294	\$ 43,185	\$ 43,230	\$ 47,666
Real property depreciation and amortization	40,112	35,298	28,379	28,061	29,570
Real property depreciation - discontinued operations	77	102	198	203	213
Gain on property dispositions and casualty settlements	(4,729)	(245)	(6,066)	(329)	(1,301)
Funds from operations	75,240	65,449	65,696	71,165	76,148
Preferred dividends	(15,140)	(15,140)	(15,140)	(15,140)	(13,453)
Funds from operations available to common shareholders	\$ 60,100	\$ 50,309	\$ 50,556	\$ 56,025	\$ 62,695

(1) During 2012, 2011, 2010, 2009, and 2008, shareholders reinvested \$23,124, \$19,751, \$16,696, \$4,136, and \$3,941, respectively, in newly issued common stock through the Company's dividend reinvestment plan.

(2) Funds From Operations (FFO) is a non-GAAP financial measure. See page 24 for a definition of FFO and reconciliation from Net Income.

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) begins with the Company's primary business strategy to give the reader an overview of the goals of the Company's business. This is followed by a discussion of the critical accounting policies that the Company believes are important to understanding the assumptions and judgments incorporated in the Company's reported financial results. The next section, beginning on page 14, discusses the Company's results of operations for the past two years. Beginning on page 17, the Company provides an analysis of its liquidity and capital resources, including discussions of its cash flows, debt arrangements, sources of capital and financial commitments. Finally, on page 24, the Company discusses funds from operations, or FFO, which is a non-GAAP financial measure of performance of an equity REIT used by the REIT industry.

The MD&A contained in this Annual Report should be read in conjunction with the Company's Form 10-K, including the consolidated financial statements and notes thereto appearing in this report. Historical results set forth in Selected Financial Information, the Consolidated Financial Statements and Supplemental Data should not be taken as indicative of the Company's future operations.

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 long term growth in cash flow as existing leases for space in the Shopping Centers and Mixed-Use properties 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 optimize the mix of uses to improve foot traffic through the Shopping Centers. 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 goals of increasing occupancy, improving overall retail sales, and ultimately increasing cash flow as economic conditions improve. 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 leases that have 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.

During the fourth quarter of 2012, the Company acquired two properties along the Rockville Pike corridor of Rockville, Maryland, one of which is adjacent to one of the Company's existing properties. In December 2012, the Company purchased for \$23.0 million, including acquisition costs, approximately 52,700 square feet of retail space located on the east side of Rockville Pike near the Twinbrook Metro Station. The property, which was 90.5% leased to multiple tenants at December 31, 2012, is zoned for up to 745,000 square feet of rentable mixed-use space. The Company intends to redevelop the site but has not committed to any redevelopment plan or time table.

In December 2012, the Company purchased for \$12.2 million, including acquisition costs, approximately 20,100 square feet of mixed-use space, which was 40.5% leased to multiple tenants, located on the east side of Rockville Pike and adjacent to 11503 Rockville Pike, which was purchased in 2010. The property, when combined with 11503 Rockville Pike, will provide zoning for up to 331,000 square feet of rentable mixed-use space for a total development potential of up to 622,000 square feet. The Company intends to redevelop the site but has not committed to any redevelopment plan or time table.

In 2011, the Company acquired three Giant Food-anchored shopping centers located in the Maryland suburbs of the Washington, D.C. and Baltimore metropolitan area. The three centers, Kentlands Square II, Severna Park MarketPlace and Cranberry Square, total 636,000 square feet of leasable area, of which 98% is leased. The \$170.9 million purchase price, including acquisition costs, was financed with (1) \$60.0 million from two bridge loans secured by Kentlands Square II and Cranberry Square, each with an initial term of six months and accruing interest, payable monthly, at a rate equal to LIBOR plus 175 basis points; (2) a \$38.0 million non-recourse permanent loan secured by Severna Park MarketPlace; (3) approximately \$17.1 million in cash and borrowings from the Company's revolving credit facility; and (4) \$55.8 million from the issuance of equity to a related party.

In light of the limited amount of quality properties for sale and the escalated pricing of properties that the Company has been presented with or has inquired about over the past year, management believes acquisition opportunities for investment in existing and new Shopping Center and Mixed-Use Properties in the near future is uncertain. Because of its conservative capital structure, including its cash and capacity under its revolving credit facility, management believes that the Company is posi-

tioned to take advantage of additional investment opportunities as attractive properties are located and market conditions improve. (See "Item 1. Business - Capital Policies"). It is management's view that several of the sub-markets in which the Company operates have, or are expected to have in the future, attractive supply/demand characteristics. The Company will continue to evaluate acquisition, development and redevelopment as integral parts 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 generally been less severe. However, continued economic stress in the local economies where the Company's properties are located may lead to increased tenant bankruptcies, increased vacancies and decreased rental rates.

While overall consumer confidence appears to have improved, retailers continue to be cautious about capital allocation when implementing store expansion. Vacancies continue to remain elevated compared to pre-recession levels; however, the Company's overall leasing percentage on a comparative same property basis, which excludes the impact of properties not in operation for the entirety of the comparable periods, at December 31, 2012 increased to 91.9% from 90.7% at December 31, 2011, an increase in leased space of approximately 107,000 square feet, primarily caused by the leasing of a portion of the space vacated by major shopping center tenants in 2011.

Because of the Company's conservative capital structure, its liquidity has not been significantly affected by the recent turmoil in the credit markets. The Company maintains a ratio of total debt to total asset value of under 50%, which allows the Company to obtain additional secured borrowings if necessary. As of December 31, 2012, amortizing fixed-rate mortgage debt with staggered maturities from 2013 to 2027 represented approximately 93.6% of the Company's notes payable, thus minimizing refinancing risk. The Company has two fixed-rate debt maturities scheduled for 2013, one of which was refinanced on February 27, 2013. Management currently expects to repay in full the \$6.8 million remaining balance on the second loan when it matures in July 2013. The Company's variable-rate debt consists of a \$14.9 million bank term loan for the Northrock shopping center, which was refinanced on February 27, 2013, and \$38.0 million outstanding under its line of credit. As of December 31, 2012, the Company has loan availability of approximately \$136.8 million under its \$175.0 million 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, D.C./Baltimore metropolitan area and the south-eastern 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 consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"), which requires management to make certain estimates and assumptions that affect the reporting of financial position and results of operations. See Note 2 to the Consolidated Financial Statements in this report. The Company has identified the following policies that, due to estimates and assumptions inherent in those policies, involve a relatively high degree of judgment and complexity.

REAL ESTATE INVESTMENTS

Real estate investment properties are stated at historic cost less depreciation. Although the Company intends to own its real estate investment properties over a long term, from time to time it will evaluate its market position, market conditions, and other factors and may elect to sell properties that do not conform to the Company's investment profile. Management believes that the Company's real estate assets have generally appreciated in value since their acquisition or development and, accordingly, the aggregate current value exceeds their aggregate net book value and also exceeds the value of the Company's liabilities as reported in the financial statements. Because the financial statements are prepared in conformity with 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 records assets acquired and liabilities assumed, including land, buildings, and intangibles related to in-place leases and customer relationships based on their fair values. The fair value of buildings generally is determined as if the buildings were vacant upon acquisition and subsequently leased at market rental rates and considers the present value of all cash flows expected to be generated by 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 in-place lease relative to market terms for similar leases at acquisition taking into consideration the remaining contractual lease period, renewal periods, and the likelihood of the tenant exercising its renewal options. The fair value of a below market lease component is recorded as deferred income and accrued 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 are amortized over the life of the customer relationship. From time to time the Company may purchase a property for future development purposes. The property may be improved with an existing structure that would be demolished as part of the development. In such cases, the fair value of the building may be determined based only on existing leases and not include estimated cash flows related to future leases.

If there is an event or change in circumstance that indicates a potential impairment in the value of a real estate investment property, the Company prepares an analysis to determine whether the carrying value of the real estate investment property exceeds 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 the 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 fair 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. Leasehold improvements expenditures are capitalized 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. Commercial development projects are substantially complete and available for occupancy upon completion of tenant improvements, but no later than one year from the cessation of major construction activity. Residential development projects are considered substantially complete and available for occupancy

upon receipt of the certificate of occupancy from the appropriate licensing authority. 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 generally between 35 and 50 years for base buildings, or a shorter period if management determines that the building has a shorter useful life, 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 commercial leases are capitalized and amortized over the 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 are 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 throughout the term of the lease. Expense recoveries represent a portion of property operating expenses billed to tenants, including common area maintenance, real estate taxes and other recoverable costs. Expense recoveries are recognized in the period when the expenses are incurred. Rental income based on a tenant's revenue, known as percentage rent, is accrued when a tenant reports sales that exceed a specified breakpoint 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

LEGAL CONTINGENCIES

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business, which are generally covered by insurance. While the resolution of these matters cannot be predicted with certainty, the Company believes the final outcome of current 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

Same property revenue and operating income were \$160.1 million and \$119.7 million, respectively, in 2012 representing increases of \$1.5 million (1.0%) and \$2.1 million (1.8%) over 2011. Same property comparisons for 2012 and 2011 include 46 Shopping Centers and 5 Mixed-Use Properties which were in operation for the entirety of 2012 and 2011.

Same property revenue and operating income were \$151.8 million and \$112.6 million, respectively, in 2011 representing decreases of \$8.9 million (5.6%) and \$6.7 million (5.6%) compared to 2010. Same property comparisons for 2011 and 2010 include 44 Shopping Centers and 5 Mixed-Use Properties which were in operation for the entirety of 2011 and 2010.

The following is a discussion of the components of revenue and expense for the entire Company.

REVENUE					
<i>(Dollars in thousands)</i>	For the year ended December 31,			Percentage Change	
	2012	2011	2010	2012 to 2011	2011 to 2010
Base rent	\$ 152,777	\$ 138,486	\$ 126,163	10.3%	9.8%
Expense recoveries	30,391	28,368	29,488	7.1%	(3.8)%
Percentage rent	1,545	1,503	1,447	2.8%	3.9%
Other	5,379	5,521	6,010	(2.6)%	(8.1)%
Total revenue	\$ 190,092	\$ 173,878	\$ 163,108	9.3%	6.6%

Note: Base rent includes \$3,796, \$3,694, and \$227, for the years 2012, 2011, and 2010, respectively, to recognize base rent on a straight-line basis. In addition, base rent includes \$1,495, \$1,119, and \$1,024, for the years 2012, 2011, and 2010, respectively, to recognize income from the amortization of in-place leases.

Total revenue increased 9.3% in 2012 compared to 2011 primarily due to \$14.5 million of aggregate revenue generated by Clarendon Center and the three Shopping Center Properties acquired in 2011 (collectively, the "New 2012 Properties").

Total revenue increased 6.6% in 2011 compared to 2010. The increased revenue resulted primarily from (a) rental income generated by a development property (Clarendon Center) and five acquisition properties (11503 Rockville Pike, Metro Pike Center, Kentlands Square II, Severna Park MarketPlace and Cranberry Square), defined as the "2011 Acquisition Properties" and together with Clarendon Center, the "2011 Development and Acquisition Properties" (approximately \$19.1 million), offset in part by (b) (x) decreased revenue from rental properties fully in operation during both 2011 and 2010 (approximately \$8.9 million), comprised primarily of a decline in revenue generated by the Mixed-Use Properties (approximately \$4.1 million) due to a decrease in occupancy that occurred in the latter part of 2010 and the first quarter of 2011, (y) a decrease in other income compared to 2010, when the collection of rent and other damages arising from a long-standing dispute with a tenant over the non-payment of rent over a period of time was recorded (\$1.9

million), and (z) reduced expense recovery income resulting from substantial snow removal expenses incurred in 2010.

A discussion of the components of revenue follows.

BASE RENT

The \$14.3 million increase in base rent in 2012 compared to 2011 was attributable to \$12.4 million of increased base rent generated by the New 2012 Properties and \$2.3 million of increased base rent in the remainder of the portfolio.

The \$12.3 million increase in base rent in 2011 compared to 2010 was primarily attributable to the 2011 Development and Acquisition Properties (approximately \$16.8 million) which was offset in part by decreases at same center Mixed-Use Properties (approximately \$3.0 million) and the Shopping Centers (approximately \$1.9 million).

EXPENSE RECOVERIES

Expense recovery income increased \$2.0 million in 2012 compared to 2011 primarily due to \$1.7 million of increased expense recovery income generated by the New 2012 Properties.

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Expense recovery income decreased \$1.1 million in 2011 compared to 2010 due primarily to recovery in 2010 of snow removal expenses incurred as a result of severe winter weather impacting the Mid-Atlantic states during January and February 2010.

OTHER REVENUE

The decline in operating income in 2012 compared to 2011 is primarily due to the collection in 2011 of \$325,000 of past due rents from a former tenant, partially offset by increased parking income at the Mixed-Use Properties.

Other revenue decreased in 2011 primarily due to the collection during 2010 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 \$1.9 million) partially offset by increased residential tenant fees and parking income (combined \$755,000) at Clarendon Center.

OPERATING EXPENSES					
<i>(Dollars in thousands)</i>	For the year ended December 31,			Percentage Change	
	2012	2011	2010	2012 to 2011	2011 to 2010
Property operating expenses	\$ 23,794	\$ 24,715	\$ 22,897	(3.7)%	7.9%
Provision for credit losses	1,151	1,880	1,334	(38.8)%	40.9%
Real estate taxes	22,325	18,435	17,744	21.1%	3.9%
Interest expense and amortization of deferred debt	49,544	45,324	34,799	9.3%	30.2%
Depreciation and amortization	40,112	35,298	28,379	13.6%	24.4%
General and administrative	14,274	14,256	13,968	0.1%	2.1%
Predevelopment Expenses	2,667	–	–	N/A	N/A
Total operating expenses	\$ 153,867	\$ 139,908	\$ 119,121	10.0%	17.5%

Total operating expenses increased 10.0% in 2012 compared to 2011 primarily due to increased real estate taxes, interest expense, depreciation expense and predevelopment expense. Total operating expenses increased 17.5% in 2011 compared to 2010 primarily due to increased interest and depreciation expense arising from the operation of the 2011 Development and Acquisition Properties.

PROPERTY OPERATING EXPENSES

Property operating expenses decreased \$900,000 in 2012 compared to 2011 primarily due to lower snow removal costs.

Property operating expenses increased \$1.8 million in 2011 primarily due to operating expenses arising from the operation of the 2011 Development and Acquisition Properties (\$3.3 million) and modest increases in non-snow removal same property operating expenses offset in part by a \$2.3 million decrease in snow removal expense.

PROVISION FOR CREDIT LOSSES

The provision for credit losses represents the Company's estimate of amounts owed by tenants that may not be collectible. The \$729,000 decrease in 2012 compared to 2011 reflects a general improvement in the retail economy and lack of significant bankruptcy losses among the Company's various tenants. The \$546,000 increase in 2011 compared to 2010 reflects the continued stress of a stagnant housing market and slowly recovering

jobs market in the local economies where the Current Portfolio Properties are located. Approximately \$505,000 of the increase was caused by the SuperFresh and Borders Bookstore bankruptcies and a local grocery store vacancy.

REAL ESTATE TAXES

The \$3.9 million increase in real estate taxes in 2012 compared to 2011 is comprised of increased property taxes charged by the District of Columbia and taxes related to the New 2012 Properties. The \$691,000 increase in real estate taxes in 2011 over 2010 resulted primarily from the operation of the 2011 Development and Acquisition Properties.

INTEREST AND AMORTIZATION OF DEFERRED DEBT

Interest expense increased \$4.2 million in 2012 compared to 2011 primarily due to approximately \$4.1 million of interest related to \$67.2 million of higher average debt balances and \$1.9 million of reduced capitalized interest, partially offset by \$2.1 million of lower interest resulting from lower average cost of debt.

Interest expense increased \$10.5 million in 2011 compared to 2010 primarily due to Clarendon Center, because more than 85% of the project was placed in service during 2011, which caused an \$8.9 million increase in interest expense, net of amounts capitalized, as well as increased interest expense arising from the refinancing in March 2011 of the project's construction

loan with a higher fixed-rate, 15 year mortgage. Interest expense also increased in 2011 by \$1.3 million from debt incurred to finance the 2011 Acquisition Properties.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization of deferred leasing costs increased \$4.8 million in 2012 compared to 2011 primarily due to the New 2012 Properties.

Depreciation and amortization of deferred leasing costs increased \$6.9 million in 2011 compared to 2010 primarily as a result of depreciation commencement for the 2011 Development and Acquisition Properties placed in service during 2011.

GENERAL AND ADMINISTRATIVE

General and administrative expenses increased \$288,000 in 2011 compared to 2010 primarily due to increased local taxes.

PREDEVELOPMENT EXPENSES

Predevelopment expenses represent costs incurred, primarily lease termination costs, in preparation of the potential repositioning of Van Ness Square.

ACQUISITION RELATED COSTS

Acquisition related costs in 2012 totaling approximately \$1.1 million arose from the December 2012 purchases of 1500 Rockville Pike and 5541 Nicholson Lane.

Acquisition related costs in 2011 totaling approximately \$2.5 million arose from the Company's September 23, 2011, purchase of Kentlands Square II, Severna Park MarketPlace and Cranberry Square and the February 17, 2011 purchase of a 3,000 square foot retail property located adjacent to the Company's Van Ness Square in Washington, D.C.

Acquisition related costs totaling approximately \$1.2 million in 2010 relate to the Company's October 1, 2010 purchase of a 20,000 square foot property and December 17, 2010 purchase of a 67,500 square foot property, both located near the White Flint Metro Station in Montgomery County, Maryland.

GAIN ON CASUALTY SETTLEMENT

Gain on casualty settlement in 2012 reflects insurance proceeds received in excess of the carrying value of assets damaged during a hail storm at French Market in 2012. Gain on casualty settlement in 2011 and 2010 reflects insurance proceeds received in excess of the carrying value of assets damaged during a severe hail storm at French Market in May 2010. In each instance, the insurance proceeds funded substantially all of the restoration of the damaged property.

LOSS ON EARLY EXTINGUISHMENT OF DEBT

In June 2010, the Company refinanced its Thruway shopping center, located in Winston-Salem, North Carolina. The \$45.6 million loan requires principal and interest payments calculated using a 5.83% interest rate and a 25-year amortization schedule, and matures in ten years. In December 2010, the Company refinanced its Ravenwood shopping center, located in Baltimore, Maryland. The \$17.0 million loan requires principal and interest payments calculated using a 6.18% interest rate and a 25-year amortization schedule, and matures in 15 years. These loans refinanced a portion of a 7.67%, multi-property loan that was scheduled to mature in October 2012. In conjunction with the refinancings, the Company incurred costs to retire the previous Thruway debt totaling \$4.5 million (approximately \$4.4 million to defease the original loan and write-offs of unamortized deferred debt costs of approximately \$54,000) and to retire the previous Ravenwood debt totaling \$926,000 (approximately \$912,000 to defease the original loan and write-offs of unamortized deferred debt costs of approximately \$14,000). The transactions reduced the Company's future refinancing risk by decreasing the amount of debt maturing in 2012 from \$95.7 million to \$62.0 million, and provided net cash proceeds of approximately \$17.4 million.

GAIN ON SALE OF PROPERTY

Gain on sales of properties in 2012 resulted from the July 2012 sale of West Park shopping center and the December 2012 sale of the Belvedere shopping center.

Gain on sale of property in 2010 resulted from the sale of the Lexington Center land parcel and Lexington pads.

IMPACT OF INFLATION

Inflation has remained relatively low during 2012 and 2011. The impact of rising operating expenses due to inflation on the operating performance of the Company's portfolio would have been mitigated by terms in substantially all of the Company's leases which contain provisions designed to increase revenues to offset the adverse impact of inflation on the Company's results of operations. These provisions include upward periodic adjustments in base rent due from tenants, usually based on a stipulated increase and to a lesser extent on a factor of the change in the consumer price index, commonly referred to as the CPI.

In addition, substantially all of the Company's properties are leased to tenants under long-term leases, which provide for reimbursement of operating expenses by tenants. These leases tend to reduce the Company's exposure to rising property expenses due to inflation. Inflation and increased costs may have an adverse impact on the Company's tenants if increases in their operating expenses exceed increases in their revenue.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were \$12.1 million and \$12.3 million at December 31, 2012 and 2011, respectively. The changes in cash and cash equivalents during the years ended December 31, 2012 and 2011 were attributable to operating, investing and financing activities, as described below.

<i>(Dollars in thousands)</i>	Year Ended December 31,	
	2012	2011
Net cash provided by operating activities	\$ 78,423	\$ 55,669
Net cash used in investing activities	(46,873)	(201,500)
Net cash provided by/used in financing activities	(31,740)	145,186
Decrease in cash and cash equivalents	\$ (190)	\$ (645)

OPERATING ACTIVITIES

Net cash provided by operating activities increased \$22.7 million to \$78.4 million for the year ended December 31, 2012 compared to \$55.7 million for the year ended December 31, 2011, primarily reflecting the full year operating effect of properties acquired in September 2011. Net cash provided by operating activities represents, in each year, cash received primarily from rental income, plus other income, less property operating expenses, normal recurring general and administrative expenses and interest payments on debt outstanding.

INVESTING ACTIVITIES

Net cash used in investing activities decreased \$154.6 million to \$46.9 million for the year ended December 31, 2012 compared to \$201.5 million for the year ended December 31, 2011. Investing activities in 2012 primarily reflect (a) the purchases of 1500 Rockville Pike and 5541 Nicholson Lane (b) tenant improvements and capital expenditures and (c) Clarendon Center and Ashland Square Phase I development costs partially offset by (d) proceeds from the sales of West Park and Belvedere and (e) proceeds from casualty settlement. Investing activities for 2011 primarily reflect the purchase of Cranberry Square, Kentlands Square II and Severna Park MarketPlace and Clarendon Center construction costs.

Tenant improvement and property capital expenditures totaled \$12.7 million and \$11.6 million for 2012 and 2011, respectively.

FINANCING ACTIVITIES

Net cash used in financing activities was \$31.7 million for the year ended December 31, 2012. Net cash provided by financing activities for the year ended December 31, 2011, was \$145.2 million. Net cash used in financing activities for the year ended December 31, 2012 primarily reflects:

- the repayment of mortgage notes payable totaling \$117.6 million;
- distributions made to common stockholders and holders of convertible limited partnership units in the Operating Partnership during the year totaling \$38.1 million;
- distributions made to preferred stockholders during the year totaling \$15.1 million;
- repayments of \$8.0 million on the revolving credit facility; and
- payments of \$2.2 million for financing costs of new mortgage loans;

which was partially offset by:

- proceeds received from one new and one modified mortgage notes payable totaling \$83.5 million;
- proceeds of \$38.0 million from the revolving credit facility; and
- \$27.8 million of proceeds received from the issuance of common stock under the dividend reinvestment program and from the exercise of stock options.

Cash provided by financing activities for the year ended December 31, 2011 primarily reflects:

- proceeds of \$226.0 million received from mortgage notes payable;
- proceeds of \$60.0 million received from secured bridge financing loans;
- proceeds of \$13.4 million received from construction loan draws;
- proceeds of \$16.0 million received from revolving credit facility draws;
- proceeds of \$55.8 million from an equity offering of common stock and limited partnership units in the Operating Partnership; and
- proceeds of \$20.9 million from the issuance of common stock under the dividend reinvestment program, directors deferred plan and the exercise of stock options;

which was partially offset by:

- the repayment of mortgage notes payable totaling \$22.7 million;
- the repayment of secured bridge financing loans totaling \$60.0 million;
- the repayment of construction loans payable totaling \$104.2 million;
- the repayment of amounts borrowed under the revolving credit facility of \$8.0 million;
- distributions to common stockholders totaling \$27.1 million;
- distributions to holders of convertible limited partnership units in the Operating Partnership totaling \$8.3 million;
- distributions made to preferred stockholders totaling \$15.1 million; and
- payments of \$1.4 million 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. Management anticipates that during the coming years the Company will commence activities related to the redevelopment of Van Ness Square and the adjacent 4469 Connecticut Avenue and may develop additional freestanding outparcels or expansions within certain of the Shopping Centers. Although not currently planned, it is possible that the Company

may redevelop additional 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 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.

Any future 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.

CONTRACTUAL PAYMENT OBLIGATIONS

As of December 31, 2012, the Company had unfunded contractual payment obligations of approximately \$110.6 million, excluding operating obligations, due within the next 12 months. The table below shows the total contractual payment obligations as of December 31, 2012.

CONTRACTUAL PAYMENT OBLIGATIONS

<i>(Dollars in thousands)</i>	Payments Due By Period				Total
	One Year or Less	2-3 Years	4-5 Years	After 5 Years	
Notes Payable:					
Interest	\$ 44,095	\$ 81,751	\$ 75,052	\$ 185,757	\$ 386,655
Scheduled Principal	19,212	39,886	43,369	148,817	251,284
Balloon Payments	37,305	28,295	38,000	472,892	576,492
Subtotal	100,612	149,932	156,421	807,466	1,214,431
Ground Leases ⁽¹⁾	176	352	352	9,538	10,418
Corporate Headquarters Lease ⁽¹⁾	818	1,711	1,045	–	3,574
Development Obligations	8,953	–	–	–	8,953
Total Contractual Obligations	\$ 110,559	\$ 151,995	\$ 157,818	\$ 817,004	\$1,237,376

(1) See Note 7 to Consolidated Financial Statements. Corporate Headquarters Lease amounts represent an allocation to the Company based upon employees' time dedicated to the Company's business as specified in the Shared Services Agreement. Future amounts are subject to change as the number of employees employed by each of the parties to the lease fluctuates.

Management believes that the Company's cash flow from operations and its capital resources, which at December 31, 2012 included cash balances of \$12.1 million and borrowing availability

of approximately \$136.8 million on its revolving line of credit, will be sufficient to meet its contractual obligations for the foreseeable future.

PREFERRED STOCK ISSUES

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 plus accrued but unpaid dividends. 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. On January 31, 2013, the Company issued a notice to redeem 60% of the outstanding depositary shares at a price of \$25.00 per depositary share, plus accrued dividends. The redemption was completed on March 2, 2013.

In March 2008, the Company sold, in an underwritten public offering, 3,173,115 depositary shares, each representing 1/100th of a share of 9% Series B Cumulative Redeemable Preferred Stock, providing net cash proceeds of \$76.3 million. The depositary shares may be redeemed at the Company's option, in whole or in part, at the \$25.00 liquidation preference plus accrued but unpaid dividends 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 first dividend was paid on July 15, 2008 and covered the period from March 27, 2008 through June 30, 2008. 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. On February 12, 2013, the Company issued a notice to redeem all of the outstanding depositary shares at a price of \$25.00 per depositary share, plus accrued dividends. The redemption date is March 15, 2013.

In February 2013, the Company sold, in an underwritten public offering, 5.6 million depositary shares, each representing 1/100th of a share of 6.875% Series C Cumulative Redeemable Preferred Stock, providing net cash proceeds of approximately \$135.0 million. The depositary shares may be redeemed at the Company's option, in whole or in part, at the \$25.00 liquidation preference plus accrued but unpaid dividends on or after February 12, 2018. The depositary shares pay an annual dividend of \$1.71875 per share, equivalent to 6.875% of the \$25.00 liquidation preference. The first dividend is scheduled to be paid on April 15, 2013 and covers the period from February 12, 2013 through March 31, 2013. The Series C 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 except

in connection with certain changes of control or delisting events. 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.

DIVIDEND REINVESTMENTS

In December 1995, the Company established a Dividend Reinvestment Plan (the "Plan") to allow its common stockholders and holders of limited partnership interests an opportunity to buy additional shares of common stock by reinvesting all or a portion of their dividends or distributions. The Plan provides for investing in newly issued shares of common stock at a 3% discount from market price without payment of any brokerage commissions, service charges or other expenses. All expenses of the Plan are paid by the Company. The Company issued 586,838 and 489,890 shares under the Plan at a weighted average discounted price of \$38.85 and \$39.64 per share during the years ended December 31, 2012 and 2011, respectively. The Company also credited 8,551 and 8,358 shares to directors pursuant to the reinvestment of dividends specified by the Directors' Deferred Compensation Plan at a weighted average discounted price of \$38.76 and \$39.94 per share, during the years ended December 31, 2012 and 2011, 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 December 31, 2012.

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

The following is a summary of notes payable as of December 31, 2012 and 2011:

NOTES PAYABLE				
(Dollars in thousands)	December 31,		Interest Rate *	Scheduled Maturity *
	2012	2011		
Fixed rate mortgages:	\$			
	– (a)	64,844	7.67%	Oct-2012
	– (b)	10,244	6.12%	Jan-2013
	– (c)	24,598	7.88%	Jan-2013
	15,750 (d)	16,032	4.67%	Jun-2013
	6,936 (e)	7,203	5.77%	Jul-2013
	13,875 (f)	14,335	5.40%	May-2014
	16,798 (g)	17,415	7.45%	Jun-2015
	34,373 (h)	35,435	6.01%	Feb-2018
	38,388 (i)	39,757	5.88%	Jan-2019
	12,418 (j)	12,860	5.76%	May-2019
	17,145 (k)	17,755	5.62%	Jul-2019
	17,040 (l)	17,627	5.79%	Sep-2019
	15,176 (m)	15,713	5.22%	Jan-2020
	11,421 (n)	11,670	5.60%	May-2020
	10,288 (o)	10,636	5.30%	Jun-2020
	43,424 (p)	44,333	5.83%	Jul-2020
	8,934 (q)	9,204	5.81%	Feb-2021
	6,359 (r)	6,477	6.01%	Aug-2021
	36,699 (s)	37,377	5.62%	Jun-2022
	11,129 (t)	11,317	6.08%	Sep-2022
	11,989 (u)	12,172	6.43%	Apr-2023
	16,247 (v)	16,858	6.28%	Feb-2024
	17,469 (w)	17,791	7.35%	Jun-2024
	15,140 (x)	15,409	7.60%	Jun-2024
	26,635 (y)	16,494	7.02%	Jul-2024
	31,709 (z)	32,281	7.45%	Jul-2024
	31,490 (aa)	32,044	7.30%	Jan-2025
	16,419 (bb)	16,731	6.18%	Jan-2026
	120,822 (cc)	123,372	5.31%	Apr-2026
	36,986 (dd)	37,858	4.30%	Oct-2026
	41,970 (ee)	42,923	4.53%	Nov-2026
	19,569 (ff)	20,000	4.70%	Dec-2026
	72,233 (gg)	–	5.84%	May-2027
Total fixed rate	774,831	808,765	5.82%	10.0 Years
Variable rate loans:				
Revolving credit facility	38,000 (hh)	8,000	LIBOR + 1.90%	May-2016
Northrock bank term loan	14,945 (ii)	15,106	LIBOR + 3.00%	May-2013
Total variable rate	52,945	23,106	2.80%	3.4 Years
Total notes payable	\$ 827,776	\$ 831,871	5.77%	9.7 Years

* Interest rate and scheduled maturity data presented as of December 31, 2012. Totals computed using weighted averages.

- (a) The loan was collateralized by seven shopping centers (Seven Corners, White Oak, Hampshire Langley, Great Eastern, Southside Plaza, Belvedere and Giant) and required equal monthly principal and interest payments of \$734,000 based upon a 25-year amortization schedule and a final payment of \$62.0 million at loan maturity. The loan was repaid in full in 2012.
- (b) The loan was collateralized by Smallwood Village Center and required equal monthly principal and interest payments of \$71,000 based upon a 30-year amortization schedule and a final payment of \$10.1 million at loan maturity. The loan was repaid in full in 2012.
- (c) The loan was collateralized by 601 Pennsylvania Avenue and required equal monthly principal and interest payments of \$294,000 based upon a 25-year amortization schedule and a final payment of \$23.0 million at loan maturity. The loan was repaid in full in 2012.
- (d) The loan, together with a corresponding interest-rate swap, was assumed with the December 17, 2010 acquisition of, and is collateralized by, Metro Pike Center. On a combined basis, the loan and the swap required interest only payments of \$63,000 until August 1, 2011, then equal monthly payments of \$86,000 based upon a 25-year amortization schedule and a final payment of \$15.6 million at loan maturity. Principal of \$282,000 was amortized during 2012.
- (e) The loan is collateralized by Cruse MarketPlace and requires equal monthly principal and interest payments of \$56,000 based upon an amortization schedule of approximately 24 years and a final payment of \$6.8 million at loan maturity. Principal of \$267,000 was amortized during 2012.
- (f) The loan is collateralized by Seabreeze Plaza and requires equal monthly principal and interest payments totaling \$102,000 based upon a weighted average 26-year amortization schedule and a final payment of \$13.3 million is due at loan maturity. Principal of \$460,000 was amortized during 2012.
- (g) The loan is collateralized by Shops at Fairfax and Boulevard shopping centers and requires equal monthly principal and interest payments totaling \$156,000 based upon a weighted average 23-year amortization schedule and a final payment of \$15.2 million is due at loan maturity. Principal of \$617,000 was amortized during 2012.
- (h) The loan is collateralized by Washington Square and requires equal monthly principal and interest payments of \$264,000 based upon a 27.5-year amortization schedule and a final payment of \$28.0 million at loan maturity. Principal of \$1.1 million was amortized during 2012.
- (i) The loan is collateralized by three shopping centers, Broadlands Village, The Glen and Kentlands Square I, and requires equal monthly principal and interest payments of \$306,000 based upon a 25-year amortization schedule and a final payment of \$28.4 million at loan maturity. Principal of \$1.4 million was amortized during 2012.
- (j) The loan is collateralized by Olde Forte Village and requires equal monthly principal and interest payments of \$98,000 based upon a 25-year amortization schedule and a final payment of \$9.0 million at loan maturity. Principal of \$442,000 was amortized during 2012.
- (k) The loan is collateralized by Countryside and requires equal monthly principal and interest payments of \$133,000 based upon a 25-year amortization schedule and a final payment of \$12.3 million at loan maturity. Principal of \$610,000 was amortized during 2012.
- (l) The loan is collateralized by Briggs Chaney MarketPlace and requires equal monthly principal and interest payments of \$133,000 based upon a 25-year amortization schedule and a final payment of \$12.2 million at loan maturity. Principal of \$587,000 was amortized during 2012.
- (m) The loan is collateralized by Shops at Monocacy and requires equal monthly principal and interest payments of \$112,000 based upon a 25-year amortization schedule and a final payment of \$10.6 million at loan maturity. Principal of \$537,000 was amortized during 2012.
- (n) The loan is collateralized by Boca Valley Plaza and requires equal monthly principal and interest payments of \$75,000 based upon a 30-year amortization schedule and a final payment of \$9.1 million at loan maturity. Principal of \$249,000 was amortized during 2012.
- (o) The loan is collateralized by Palm Springs Center and requires equal monthly principal and interest payments of \$75,000 based upon a 25-year amortization schedule and a final payment of \$7.1 million at loan maturity. Principal of \$348,000 was amortized during 2012.
- (p) The loan and a corresponding interest-rate swap closed on June 29, 2010 and are collateralized by Thruway. On a combined basis, the loan and the interest-rate swap require equal monthly principal and interest payments of \$289,000 based upon a 25-year amortization schedule and a final payment of \$34.8 million at loan maturity. Principal of \$909,000 was amortized during 2012.
- (q) The loan is collateralized by Jamestown Place and requires equal monthly principal and interest payments of \$66,000 based upon a 25-year amortization schedule and a final payment of \$6.1 million at loan maturity. Principal of \$270,000 was amortized during 2012.
- (r) The loan is collateralized by Hunt Club Corners and requires equal monthly principal and interest payments of \$42,000 based upon a 30-year amortization schedule and a final payment of \$5.0 million, at loan maturity. Principal of \$118,000 was amortized during 2012.
- (s) The loan is collateralized by Lansdowne Town Center and requires monthly principal and interest payments of \$230,000 based on a 30-year amortization schedule and a final payment of \$28.2 million at loan maturity. Principal of \$678,000 was amortized during 2012.
- (t) The loan is collateralized by Orchard Park and requires equal monthly principal and interest payments of \$73,000 based upon a 30-year amortization schedule and a final payment of \$8.6 million at loan maturity. Principal of \$188,000 was amortized during 2012.
- (u) The loan is collateralized by BJ's Wholesale and requires equal monthly principal and interest payments of \$80,000 based upon a 30-year amortization schedule and a final payment of \$9.3 million at loan maturity. Principal of \$183,000 was amortized during 2012.
- (v) The loan is collateralized by Great Falls shopping center. The loan consists of three notes which require equal monthly principal and interest payments of \$138,000 based upon a weighted average 26-year amortization schedule and a final payment of \$6.3 million at maturity. Principal of \$611,000 was amortized during 2012.
- (w) The loan is collateralized by Leesburg Pike and requires equal monthly principal and interest payments of \$135,000 based upon a 25-year amortization schedule and a final payment of \$11.5 million at loan maturity. Principal of \$322,000 was amortized during 2012.
- (x) The loan is collateralized by Village Center and requires equal monthly principal and interest payments of \$119,000 based upon a 25-year amortization schedule and a final payment of \$10.1 million at loan maturity. Principal of \$269,000 was amortized during 2012.
- (y) The loan is collateralized by White Oak and requires equal monthly principal and interest payments of \$193,000 based upon a 24.4 year weighted amortization schedule and a final payment of \$18.5 million at loan maturity. The loan was previously collateralized by Van Ness Square. During 2012, the Company substituted White Oak as the collateral and borrowed an additional \$10.5 million. Principal of \$359,000 was amortized during 2012.
- (z) The loan is collateralized by Avenel Business Park and requires equal monthly principal and interest payments of \$246,000 based upon a 25-year amortization schedule and a final payment of \$20.9 million at loan maturity. Principal of \$572,000 was amortized during 2012.
- (aa) The loan is collateralized by Ashburn Village and requires equal monthly principal and interest payments of \$240,000 based upon a 25-year amortization schedule and a final payment of \$20.5 million at loan maturity. Principal of \$554,000 was amortized during 2012.

(bb) The loan is collateralized by Ravenwood and requires equal monthly principal and interest payments of \$111,000 based upon a 25-year amortization schedule and a final payment of \$10.1 million at loan maturity. Principal of \$312,000 was amortized during 2012.

(cc) The loan is collateralized by Clarendon Center and requires equal monthly principal and interest payments of \$753,000 based upon a 25-year amortization schedule and a final payment of \$70.5 million at loan maturity. Principal of \$2.6 million was amortized during 2012.

(dd) The loan is collateralized by Severna Park MarketPlace and requires equal monthly principal and interest payments of \$207,000 based upon a 25-year amortization schedule and a final payment of \$20.3 million at loan maturity. Principal of \$872,000 was amortized during 2012.

(ee) The loan is collateralized by Kentlands Square II and requires equal monthly principal and interest payments of \$240,000 based upon a 25-year amortization schedule and a final payment of \$23.1 million at loan maturity. Principal of \$953,000 was amortized during 2012.

(ff) The loan is collateralized by Cranberry Square and requires equal monthly principal and interest payments of \$113,000 based upon a 25-year amortization schedule and a final payment of \$10.9 million at loan maturity. Principal of \$431,000 was amortized during 2012.

(gg) The loan in the original amount of \$73.0 million closed in May 2012, is collateralized by Seven Corners and requires equal monthly principal and interest payments of \$463,200 based upon a 25-year amortization schedule and a final payment of \$42.3 million at loan maturity. Principal of \$767,000 was amortized during 2012.

(hh) The loan is a \$175.0 million unsecured revolving credit facility. Interest accrues at a rate equal to the sum of one-month LIBOR plus a spread of 1.90%. The line may be extended at the Company's option for one year with payment of a fee of 0.20%. Monthly payments, if required, are interest only and vary depending upon the amount outstanding and the applicable interest rate for any given month.

(ii) The loan is collateralized by Northrock and requires monthly principal and interest payments of \$13,409 and a final payment of \$14.9 million at maturity. Principal of \$161,000 was amortized during 2012.

The carrying value of properties collateralizing the mortgage notes payable totaled \$916.1 million and \$997.5 million as of December 31, 2012 and 2011, respectively. The Company's credit facility requires the Company and its subsidiaries to maintain certain financial covenants, which are summarized below. As of December 31, 2012, the Company was in compliance with all such covenants:

- maintain tangible net worth, as defined in the loan agreement, of at least \$503.3 million plus 80% of the Company's net equity proceeds received after May 2012;
- 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 2.0x on a trailing four-quarter basis (interest expense coverage);
- limit the amount of debt so that interest, scheduled principal amortization and preferred dividend coverage exceeds 1.3x on a trailing four-quarter basis (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.

2013 FINANCING ACTIVITY

On February 27, 2013, the Company closed on a three-year \$15.6 million mortgage loan secured by Metro Pike Center. The loan matures in 2016, bears interest at a variable rate equal to the sum of one-month LIBOR and 165 basis points, requires monthly principal and interest payments based on a 25-year amortization schedule and requires a final payment of \$14.7 million at maturity. The loan may be extended for up to two-years. Proceeds were used to pay-off the \$15.9 million remaining balance of existing debt secured by Metro Pike Center, and to extinguish the related swap agreement, which were scheduled to mature in June 2013.

On February 27, 2013, the Company closed on a three-year \$15.0 million mortgage loan secured by Northrock. The loan matures in 2016, bears interest at a variable rate equal to the sum of one-month LIBOR and 165 basis points, requires monthly principal and interest payments based on a 25-year amortization schedule and requires a final payment of \$14.2 million at maturity. The loan may be extended for up to two years. Proceeds were used to pay-off the \$15.0 million remaining balance of existing debt secured by Northrock, which was scheduled to mature in May 2013.

2012 FINANCING ACTIVITY

On April 11, 2012, the Company closed on a 15-year non-recourse mortgage loan in the amount of \$73.0 million secured by Seven Corners shopping center. The loan matures in May 2027, bears interest at a fixed rate of 5.84%, requires equal monthly principal and interest payments totaling \$463,226 based upon a 25-year amortization schedule and a final payment of \$42.5 million at maturity. Proceeds from the loan were used to pay-off the \$63 million remaining balance of existing debt secured by Seven Corners and six other Shopping Center properties, which was scheduled to mature in October 2012, and to provide cash of approximately \$10 million.

On April 26, 2012, the Company substituted the White Oak shopping center for Van Ness Square as collateral for one of its existing mortgage loans which will allow the Company to analyze the feasibility of repositioning Van Ness Square. The terms of the original loan, including its 8.11% interest rate, are unchanged and, in conjunction with the collateral substitution, the Company borrowed an additional \$10.5 million, also secured by White Oak. The new borrowing requires equal monthly payments based upon a fixed 4.90% interest rate and 25-year amortization schedule, and will mature in July 2024, concurrently with the original loan. The consolidated loan requires equal monthly payments based upon a blended fixed interest rate of 7.0% and will require a final payment of \$18.5 million at maturity.

On May 21, 2012, the Company replaced its existing unsecured revolving credit facility with a new \$175.0 million facility that expires on May 20, 2016. The facility, which provides working capital and funds for acquisitions, certain developments, redevelopments and letters of credit, may be extended for one year, at the Company's option, subject to the satisfaction of certain conditions. Loans under the facility bear interest at a rate equal to the sum of LIBOR and a margin, based on the Company's leverage ratio, ranging from 160 basis points to 250 basis points. Based on the leverage ratio of December 31, 2012, the margin was 190 basis points.

2011 FINANCING ACTIVITY

On March 23, 2011, the Company closed on a 15-year non-recourse mortgage loan in the amount of \$125.0 million, secured by Clarendon Center. The loan matures April 5, 2026, bears interest at a fixed rate of 5.31%, requires equal monthly principal and interest payments of \$753,000, based upon a 25-year amortization schedule, and requires a final principal payment of approximately \$70.5 million at maturity. Proceeds from the loan were used to repay \$104.2 million outstanding on the Clarendon Center construction loan.

On September 23, 2011, the Company closed on a 15-year non-recourse mortgage loan in the amount of \$38.0 million, secured by Severna Park MarketPlace. The loan matures October 1, 2026, bears interest at a fixed rate of 4.30%, requires equal monthly principal and interest payments of \$207,000, based upon a 25-year amortization schedule, and requires a final principal payment of approximately \$20.3 million at maturity. Proceeds from the loan were used to purchase Severna Park MarketPlace.

Also on September 23, 2011, the Company closed on two six-month bridge financing loans in the total amount of \$60.0 million, secured by Kentlands Square II and Cranberry Square. Proceeds from the loans were used to purchase Kentlands Square II and Cranberry Square.

On October 5, 2011, the Company closed on a new 15-year non-recourse mortgage loan in the amount of \$43.0 million, secured by Kentlands Square II. The loan matures November 5, 2026, bears interest at a fixed rate of 4.53%, requires equal monthly principal and interest payments of \$240,000, based upon a 25-year principal amortization, and requires a final principal payment of approximately \$23.1 million at maturity. Proceeds from the loan were used to repay the \$40.0 million bridge financing used to acquire Kentlands Square II.

On November 6, 2011, the Company closed on a new 15-year non-recourse mortgage loan in the amount of \$20.0 million, secured by Cranberry Square. The loan matures December 1, 2026, bears interest at a fixed rate of 4.70%, requires equal monthly principal and interest payments of \$113,000, based upon a 25-year principal amortization, and requires a final principal payment of approximately \$10.9 million at maturity.

Proceeds from the loan were used to repay the \$20.0 million bridge financing used to acquire Cranberry Square.

2010 FINANCING ACTIVITY

On June 29, 2010, the Company closed on a new 10-year mortgage loan in the amount of \$45.6 million, secured by Thruway. The loan matures July 1, 2020, and bears interest at a variable rate equal to the sum of one-month LIBOR and 260 basis points. In conjunction with the financing, the Company entered into an interest rate swap agreement with a \$45.6 million notional amount to manage the interest rate risk associated with the above \$45.6 million 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%. The Company has designated this agreement as a cash flow hedge for accounting purposes. The Company recognizes interest expense on the combined variable-rate debt and the interest-rate swap at the effective fixed rate of 5.83%. On a combined basis, the loan and the interest-rate swap require equal monthly principal and interest payments of approximately \$289,000, based upon an assumed interest rate of 5.83% and a 25-year principal amortization, and requires a final principal payment of approximately \$34.8 million at maturity.

Prior to the refinancing, Thruway was one of nine properties securing debt included in a collateralized mortgage-backed security (CMBS) with an outstanding balance of \$108.3 million, an interest rate of 7.67% and due to mature October 2012. In order to release Thruway, the Company defeased \$30.2 million of the outstanding balance at a cost of approximately \$4.4 million, using proceeds from the new mortgage financing.

On August 24, 2010, the Company entered into an amendment to its Northrock construction loan to provide an option to extend the loan for two years. The extension is available at the Company's option subject to notice to the bank, and to a principal repayment in an amount required to cause property operating income to meet certain debt service coverage levels.

On December 9, 2010, the Company closed on a new 15-year, fixed-rate mortgage loan in the amount of \$17.0 million secured by Ravenwood. The loan matures January 2026, requires monthly interest and principal payments of approximately \$111,000 based upon a fixed interest rate of 6.18% and a 25-year principal amortization and requires a final principal payment of approximately \$10.1 million at maturity.

Prior to the refinancing, Ravenwood was one of eight remaining properties securing debt included in a CMBS with an outstanding balance of \$76.3 million, an interest rate of 7.67% and due to mature October 2012. In order to release Ravenwood, the Company defeased \$7.8 million of the outstanding balance at a cost of approximately \$900,000, using proceeds from the new mortgage financing.

On December 17, 2010, the Company purchased Metro Pike Center, a 67,000 square foot retail property located in Rockville, Maryland. In conjunction with the acquisition, the Company

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

assumed a mortgage loan with a principal balance of \$16.2 million. The loan matures June 30, 2013, bears interest at a variable rate equal to the sum of one-month LIBOR and 245 basis points. In conjunction with the loan assumption, the Company assumed a corresponding interest rate swap agreement with a \$16.2 million notional amount to manage the interest rate risk associated with the variable-rate mortgage debt. The swap agreement was effective at closing, terminates on June 30, 2013 and effectively fixes the interest rate on the mortgage debt at 4.67%. On a combined basis, the loan and the interest-rate swap require interest-only payments of approximately \$63,000 until August 1, 2011, followed by equal monthly principal and interest payments of approximately \$86,000 based upon a 25-year amortization schedule and a final payment of \$15.6 million at loan maturity.

OFF-BALANCE SHEET ARRANGEMENTS

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

FUNDS FROM OPERATIONS

In 2012, the Company reported Funds From Operations (FFO) available to common shareholders (common stockholders and limited partner unitholders) of \$60.1 million, a 19.5% increase from 2011 FFO available to common shareholders of \$50.3 million. The following table presents a reconciliation from net income to FFO available to common shareholders for the periods indicated:

FUNDS FROM OPERATIONS

The following table presents a reconciliation from net income to FFO available to common shareholders for the periods indicated:

(Dollars in thousands)	2012	For the Year Ended December 31,			
		2011	2010	2009	2008
Net income	\$ 39,780	\$ 30,294	\$ 43,185	\$ 43,230	\$ 47,666
Subtract:					
Gain on property sales	(4,510)	–	(3,591)	–	–
Gain on casualty settlement	(219)	(245)	(2,475)	(329)	(1,301)
Add:					
Real estate depreciation – discontinued operations	77	102	198	203	213
Real estate depreciation and amortization	40,112	35,298	28,379	28,061	29,570
FFO	75,240	65,449	65,696	71,165	76,148
Subtract:					
Preferred dividends	(15,140)	(15,140)	(15,140)	(15,140)	(13,453)
FFO available to common shareholders	\$ 60,100	\$ 50,309	\$ 50,556	\$ 56,025	\$ 62,695
Average shares and units used to compute FFO per share	26,614	24,740	23,793	23,359	23,377
FFP per share	\$ 2.26	\$ 2.03	\$ 2.12	\$ 2.40	\$ 2.68

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, impairment charges on depreciable real estate assets 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

Management anticipates that during the coming year the Company will commence activities related to the redevelopment of Van Ness Square and the adjacent 4469 Connecticut Avenue and may develop additional freestanding outparcels or expansions within certain of the Shopping Centers. Although not currently planned, it is possible that the Company may redevelop

additional 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, any developments, expansions or acquisitions are expected to be funded with borrowings from the Company's credit line, construction financing, proceeds

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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 following describes the acquisitions, developments, redevelopments and renovations which affected the Company's financial position and results of operations in 2012, 2011, and 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 has an approved site plan to develop a grocery-anchored neighborhood shopping center totaling approximately 160,000 square feet. Capital One Bank operates a branch on the site and the Company previously executed a lease with CVS. During 2012, the Company completed the site work for two pads, constructed a 6,500 square foot building that has been leased to a restaurant and CVS constructed a 13,000 square foot pharmacy building. Both facilities have opened for business, and the cost to the Company was approximately \$3.0 million. The balance of the center is being marketed to grocers and other retail businesses, with a development timetable yet to be finalized.

CLARENDON CENTER

In late 2010, the Company substantially completed construction of a mixed-use project which includes approximately 42,000 square feet of retail space, 171,000 square feet of office space, 244 apartments and 600 underground parking spaces, on two city blocks, adjacent to the Clarendon Metro Station in Arlington County, Virginia. Development costs are expected to total approximately \$195.0 million upon the completion of final office tenant improvements which are expected to total approximately \$2.9 million. As of December 31, 2012, 208,900 square feet (97.9%) of the commercial space (comprising of all of the retail space and 167,200 square feet (97.4%) of the office space) as well as 244 apartments (100.0%), were leased.

SEVEN CORNERS

During 2010, the Company expanded the Seven Corners shopping center by approximately 6,000 square feet. Red Robin Gourmet Burgers opened in November 2010 in a newly-constructed, free-standing building. The Company also completed construction of parking lot, landscaping and site lighting improvements to enhance the common areas.

11503 ROCKVILLE PIKE

On October 1, 2010, the Company purchased for \$15.6 million, including acquisition costs, approximately 20,000 square feet of retail space located on the east side of Rockville Pike (Route 355),

near the White Flint Metro Station in Montgomery County, Maryland. The property, which was fully leased to two tenants at December 31, 2012, is zoned for up to 297,000 square feet of rentable mixed use space. The Company intends to redevelop the property but has not committed to any redevelopment plan or time table.

METRO PIKE CENTER

On December 17, 2010, the Company purchased for \$34.3 million, including acquisition costs, approximately 67,000 square feet of retail space located on the west side of Rockville Pike (Route 355) near the White Flint Metro Station in Montgomery County, Maryland. The property was acquired subject to the assumption of a \$16.2 million mortgage loan and a corresponding interest rate swap with a fair value of \$0.5 million. The property, which was 83.6% leased to multiple tenants at December 31, 2012, is zoned for up to 807,000 square feet of rentable mixed use space. The Company does not anticipate redeveloping the property in the foreseeable future.

4469 CONNECTICUT AVENUE

On February 17, 2011, the Company purchased for \$1.7 million, including acquisition costs, approximately 3,000 square feet of retail space located adjacent to the Company's Van Ness Square in Washington D.C. The property is unoccupied and will be included in the project to redevelop Van Ness Square.

KENTLANDS SQUARE II

On September 23, 2011, the Company purchased for \$74.5 million Kentlands Square II, and incurred acquisition costs of \$1.1 million. Kentlands Square II is a 241,000 square foot neighborhood shopping center located in Gaithersburg, Maryland, in Montgomery County, the state's most populous and affluent county. More than 38,000 households, with annual household incomes averaging over \$114,000, are located within a three-mile radius of the center. As of December 31, 2012, the center was 95.8% leased and anchored by a 61,000 square foot Giant Food supermarket and a 104,000 square foot Kmart. The property is adjacent to the Company's Kentlands Square I, which is anchored by Lowe's Home Improvement and Kentlands Place.

SEVERNA PARK MARKETPLACE

On September 23, 2011, the Company purchased for \$61.0 million Severna Park Marketplace, and incurred acquisition costs of \$0.8 million. Severna Park Marketplace is a 254,000 square foot neighborhood shopping center located in Severna Park, Maryland, in Anne Arundel County. More than 15,000 households, with annual household incomes averaging over \$112,000, are located within a three-mile radius of the center. As of December 31, 2012, the center was 100% leased and anchored by a 63,000 square foot Giant Food supermarket and a 92,000 square foot Kohl's.

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CRANBERRY SQUARE

On September 23, 2011, the Company purchased for \$33.0 million Cranberry Square, and incurred acquisition costs of \$0.5 million. Cranberry Square is a 140,000 square foot neighborhood shopping center located in Westminster, Maryland, in Carroll County. More than 12,000 households, with annual household incomes averaging over \$72,000, are located within a three-mile radius of the center. As of December 31, 2012, the center was 92.2% leased and anchored by a 56,000 square foot Giant Food supermarket and a 24,000 square foot Staples.

1500 ROCKVILLE PIKE

In December 2012, the Company purchased for \$23.0 million, including acquisition costs, approximately 52,700 square feet of retail space located on the east side of Rockville Pike near the Twinbrook Metro Station. The property, which was 90.5% leased to multiple tenants at December 31, 2012, is zoned for up to 745,000 square feet of rentable mixed-use space. The Company intends to redevelop the site but has not committed to any redevelopment plan or time table.

5541 NICHOLSON LANE

In December 2012, the Company purchased for \$12.2 million, including acquisition costs, approximately 20,100 square feet of mixed-use space, which was 40.5% leased to multiple tenants, located on the east side of Rockville Pike and adjacent to 11503 Rockville Pike, which was purchased in 2010. The property, when combined with 11503 Rockville Pike, will provide zoning for up to 331,000 square feet of rentable mixed-use space for a total development potential of up to 622,000 square feet. The Company intends to redevelop the site but has not committed to any redevelopment plan or time table.

VAN NESS SQUARE

The Company recently completed negotiation of lease termination agreements with the tenants of Van Ness Square and expects the building will be vacant on or about April 30, 2013. Costs incurred related to those termination arrangements are being amortized to expense using the straight-line method over the remaining terms of the leases, are included in "Predevelopment Expenses" in the Consolidated Statements of Operations, totaled \$2.7 million in 2012 and are expected to total approximately \$3.3 million over the first two quarters of 2013. The Company intends to develop a primarily residential project with street-level retail and will recognize additional predevelopment expenses in future periods when the existing improvements of Van Ness Square and the adjacent 4469 Connecticut Avenue are demolished, the timing of which is uncertain and dependent on the issuance of various governmental approvals and permits.

PROPERTY SALES

WEST PARK

On July 25, 2012, the Company sold for \$2.0 million the 77,000 square foot West Park shopping center in Oklahoma City, Oklahoma and recorded a \$1.1 million gain. As of June 30, 2012, West Park was 11.7% leased and the carrying amounts of the associated assets and liabilities were \$1.0 million and \$207,000, respectively. There was no debt associated with the property.

BELVEDERE

In December 2012, the Company sold for \$4.0 million, the 54,900 square foot Belvedere shopping center in Baltimore, Maryland and recorded a \$3.4 million gain. As of September 30, 2012, Belvedere was 34% leased and the carrying amounts of the associated assets and liabilities were \$488,000 and \$22,000, respectively. There was no debt associated with the property.

PORTFOLIO LEASING STATUS

The following chart sets forth certain information regarding commercial leases at our properties for the periods indicated.

As of December 31,	Total Properties		Total Square Footage		Percentage Leased	
	Shopping Centers	Mixed-Use	Shopping Centers	Mixed-Use	Shopping Centers	Mixed-Use
2012	50	7	7,877,200	1,612,200	93.4%	82.8%
2011	51	7	7,930,000	1,610,400	90.8%	85.8%
2010	48	6	7,293,000	1,608,000	92.0%	81.5%

The 2012 shopping center leasing percentages include 1500 Rockville Pike and 5541 Nicholson Lane, which were acquired in December 2012, and exclude West Park and Belvedere, which were sold during 2012. The 2012 mixed-use leasing percentages include Clarendon Center commercial area, which was 97.9% leased at December 31, 2012. The Clarendon Center residential component was 100% leased at December 31, 2012. On a same property basis, which excludes the impact of properties not in operation for the entirety of the comparable periods,

Shopping Center leasing percentages increased to 93.5% from 91.6% and Mixed-Use leasing percentages decreased to 82.8% from 85.8%. The overall portfolio leasing percentage, on a comparative same center basis, ended the year at 91.9%, an increase from 90.7% at yearend 2011. The 2012 shopping center leasing percentages were impacted by a net increase of approximately 151,000 square feet of leased space, the majority of which resulted from the leasing of space vacated by major tenants during 2011. The 2012 mixed-use leasing percentages

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

were adversely impacted by a net decrease of approximately 44,000 square feet of leased space, the majority of which resulted from the early termination of leases at Van Ness Square in preparation for redevelopment.

The 2011 shopping center percentages leased included three centers acquired September 23, 2011, Kentlands Square II (100% leased), Severna Park MarketPlace (100% leased) and Cranberry Square (91% leased). The 2011 and 2010 mixed-use percentages include Clarendon Center commercial area, which was 92.4% and 58.6% leased at December 31, 2011 and 2010, respectively. The Clarendon Center residential component was 100% and 43.9% leased at December 31, 2011 and 2010, respectively. On a same property basis, shopping center leasing percentages decreased to 90.2% from 92.0% and mixed-use leasing percentages decreased to 84.9% from 85.5%. Overall portfolio leasing percentage, on a comparative same center basis, ended the year at 89.4%, a decrease from 91.1% at year end 2010. The 2011 commercial leasing percentages were adversely impacted by a net decrease of approximately 140,000 square feet of leased space, of which approximately 98,000 square feet was caused by the Syms, SuperFresh and Borders Books bankruptcies and the balance resulting from the early lease termination of a local grocer. As of March 1, 2012, a total of 61,000 square feet of these four vacant spaces had been leased.

The 2010 shopping center percentage leased included recently constructed but not yet fully leased Northrock and Westview Village, which were 72.3% and 36.1% leased as of December 31,

2010, respectively. On a same property basis, shopping center leasing percentages increased to 93.1% from 93.0%. The 2010 mixed-use percentage leased included Clarendon Center, whose construction was substantially completed at year end 2010 and whose residential component was 43.9% leased and office and retail component was 58.6% leased as of December 31, 2010. Including Clarendon Center, overall mixed-use property leasing percentages decreased to 81.5% from 90.6%. On a comparative same property basis, overall property leasing ended the year at 92.0%, a decrease from 92.7% at year end 2009, a space leased reduction of approximately 55,000 square feet. Shopping center same property leasing was 93.1% and 93.0%, and mixed-use same property leasing was 85.5% and 90.5%, as of December 31, 2010 and 2009, respectively.

The following table shows selected dates for leases executed in the indicated periods. The information is based on executed leases without adjustment for the timing of occupancy, tenant defaults, or landlord concessions. The base rent for an expiring lease is the annualized contractual base rent, on a cash basis, as of the expiration date of the lease. The base rent for a new or renewed lease is the annualized contractual base rent, on a cash basis, as of the expected rent commencement date. Because tenants that execute leases may not ultimately take possession of their space or pay all of their contractual rent, the changes presented in the table provide information only about trends in market rental rates. The actual changes in rental income received by the Company may be different.

Year Ended December 31,	Square Feet	Number of Leases	Base Rent per Square Foot	
			New/Renewed Leases	Expiring Leases
2012	1,579,000	256	\$ 16.39	\$ 16.30
2011	1,178,000	245	15.21	16.41
2010	1,336,000	253	13.19	14.62

During 2012, the Company entered into 216 new or renewed apartment leases. The monthly rent per square foot for these leases increased to \$3.31 from \$3.11.

MANAGEMENT'S REPORT on Internal Control Over Financial Reporting

ASSESSMENT OF EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Management used the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control - Integrated Framework to assess the effectiveness of the Company's internal control over financial reporting. Based upon the assessments, the Company's management

has concluded that, as of December 31, 2012, the Company's internal control over financial reporting was effective. The Company's independent registered public accounting firm has issued a report on the effectiveness of the Company's internal control over financial reporting, which appears on page 28 in this Annual Report.

REPORT

OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Saul Centers, Inc.

We have audited the accompanying consolidated balance sheets of Saul Centers, Inc. as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule listed in the Index at Item 15(a)2(b). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Saul Centers, Inc. at December 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Saul Centers, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2013 expressed an unqualified opinion thereon.

Ernst & Young LLP
McLean, Virginia
March 13, 2013

REPORT

OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
on Internal Control Over Financial Reporting

Board of Directors and Stockholders
Saul Centers, Inc.

We have audited Saul Centers, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Saul Centers, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Assessment of Effectiveness of Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the

assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Saul Centers, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Saul Centers, Inc. as of December 31, 2012 and 2011 and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2012 of Saul Centers, Inc. and our report dated March 13, 2013 expressed an unqualified opinion thereon.

Ernst & Young LLP
McLean, Virginia
March 13, 2013

CONSOLIDATED BALANCE SHEETS

<i>(Dollars in thousands, except per share amounts)</i>	December 31, 2012	December 31, 2011
Assets		
Real estate investments		
Land	\$ 353,890	\$ 324,183
Buildings and equipment	1,109,911	1,092,533
Construction in progress	2,267	1,129
	1,466,068	1,417,845
Accumulated depreciation	(353,305)	(326,397)
	1,112,763	1,091,448
Cash and cash equivalents	12,133	12,323
Accounts receivable and accrued income, net	41,406	39,094
Deferred leasing costs, net	26,102	25,876
Prepaid expenses, net	3,895	3,868
Deferred debt costs, net	7,713	7,090
Other assets	3,297	12,870
Total assets	\$ 1,207,309	\$ 1,192,569
Liabilities		
Mortgage notes payable	\$ 789,776	\$ 823,871
Revolving credit facility payable	38,000	8,000
Dividends and distributions payable	13,490	13,219
Accounts payable, accrued expenses and other liabilities	27,434	22,992
Deferred income	31,320	31,281
Total liabilities	900,020	899,363
Stockholders' equity		
Preferred stock, 1,000,000 shares authorized:		
Series A Cumulative Redeemable, 40,000 shares issued and outstanding	100,000	100,000
Series B Cumulative Redeemable, 31,731 shares issued and outstanding	79,328	79,328
Common stock, \$0.01 par value, 30,000,000 shares authorized, 20,045,452 and 19,291,845 shares issued and outstanding, respectively	201	193
Additional paid-in capital	246,557	217,829
Accumulated deficit	(154,830)	(144,659)
Accumulated other comprehensive loss	(3,553)	(2,863)
Total Saul Centers, Inc. stockholders' equity	267,703	249,828
Noncontrolling interest	39,586	43,378
Total stockholders' equity	307,289	293,206
Total liabilities and stockholders' equity	\$ 1,207,309	\$ 1,192,569

The Notes to Financial Statements are an integral part of these statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

<i>(Dollars in thousands, except per share amounts)</i>	For The Year Ended December 31,		
	2012	2011	2010
Revenue			
Base rent	\$ 152,777	\$ 138,486	\$ 126,163
Expense recoveries	30,391	23,368	29,488
Percentage rent	1,545	1,503	1,447
Other	5,379	5,521	6,010
Total revenue	190,092	173,878	163,108
Operating expenses			
Property operating expenses	23,794	24,715	22,897
Provision for credit losses	1,151	1,880	1,334
Real estate taxes	22,325	18,435	17,744
Interest expense and amortization of deferred debt costs	49,544	45,324	34,799
Depreciation and amortization of deferred leasing costs	40,112	35,298	28,379
General and administrative	14,274	14,256	13,968
Predevelopment expenses	2,667	-	-
Total operating expenses	153,867	139,908	119,121
Operating income	36,225	33,970	43,987
Acquisition related costs	(1,129)	(2,534)	(1,179)
Change in fair value of derivatives	36	(1,332)	-
Loss on early extinguishment of debt	-	-	(5,405)
Gain on casualty settlement	219	245	2,475
Income from continuing operations	35,351	30,349	39,878
Discontinued Operations			
Loss from operations of properties sold	(81)	(55)	(284)
Gain on sales of properties	4,510	-	3,591
Income (loss) from discontinued operations	4,429	(55)	3,307
Net income	39,780	30,294	43,185
Noncontrolling interest			
Income from continuing operations attributable to noncontrolling interests	(5,693)	-	(5,930)
Income from discontinued operations attributable to noncontrolling interests	(713)	(3,561)	(492)
Income attributable to noncontrolling interests	(6,406)	(3,561)	(6,422)
Net income attributable to Saul Centers, Inc.	33,374	26,733	36,763
Preferred dividends	(15,140)	(15,140)	(15,140)
Net income available to common stockholders	\$ 18,234	\$ 11,593	\$ 21,623
Per share net income available to common stockholders			
Basic and diluted:			
Continuing operations	\$ 0.70	\$ 0.61	\$ 1.00
Discontinued operations	0.23	-	0.18
	\$ 0.93	\$ 0.61	\$ 1.18

The Notes to Financial Statements are an integral part of these statements.

(Dollars in thousands)	For The Year Ended December 31,		
	2012	2011	2010
Net income	\$ 39,780	\$ 30,294	\$ 43,185
Other comprehensive income			
Change in unrealized loss on cash flow hedge	(932)	(3,195)	(543)
Total comprehensive income	38,848	27,099	42,642
Comprehensive income attributable to noncontrolling interests	6,164	2,811	6,298
Total comprehensive income attributable to Saul Centers, Inc.	32,684	24,288	36,344
Preferred dividends	(15,140)	(15,140)	(15,140)
Total comprehensive income available to common stockholders	\$ 17,544	\$ 9,148	\$ 21,204

The Notes to Financial Statements are an integral part of these statements.

(Dollars in thousands, except per share amounts)	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss)	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 544,643 shares of common stock:								
426,847 shares pursuant to dividend reinvestment plan	-	4	16,696	-	-	16,700	-	16,700
117,796 shares due to exercise of employee stock options and issuance of directors' deferred stock	-	2	3,728	-	-	3,730	-	3,730
Net income	-	-	-	36,763	-	36,763	6,422	43,185
Change in unrealized loss on cash flow hedge	-	-	-	-	(419)	(419)	(124)	(543)
Preferred stock distributions:								
Series A	-	-	-	(6,000)	-	(6,000)	-	(6,000)
Series B	-	-	-	(5,355)	-	(5,355)	-	(5,355)
Common stock distributions	-	-	-	(19,701)	-	(19,701)	(5,850)	(25,551)
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)	-	-	-	(6,681)	-	(6,681)	(1,950)	(8,631)
Balance, December 31, 2010	179,328	186	189,787	(128,926)	(419)	239,956	(143)	239,813
Issuance of 734,786 shares of common stock:								
186,968 restricted shares	-	2	6,159	-	-	6,161	-	6,161
498,248 shares pursuant to dividend reinvestment plan	-	3	19,751	-	-	19,754	-	19,754
49,570 shares due to exercise of employee stock options and issuance of directors' deferred stock	-	2	2,132	-	-	2,134	-	2,134
Issuance of 1,497,814 partnership units	-	-	-	-	-	-	49,589	49,589
Net income	-	-	-	26,733	-	26,733	3,561	30,294
Change in unrealized loss on cash flow hedge	-	-	-	-	(2,444)	(2,444)	(751)	(3,195)
Preferred stock distributions:								
Series A	-	-	-	(6,000)	-	(6,000)	-	(6,000)
Series B	-	-	-	(5,355)	-	(5,355)	-	(5,355)
Common stock distributions	-	-	-	(20,381)	-	(20,381)	(6,389)	(26,770)
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)	-	-	-	(6,945)	-	(6,945)	(2,489)	(9,434)
Balance, December 31, 2011	179,328	193	217,829	(144,659)	(2,863)	249,828	43,378	293,206
Issuance of 753,607 shares of common stock:								
595,388 shares pursuant to dividend reinvestment plan	-	6	23,124	-	-	23,130	-	23,130
158,219 shares due to exercise of employee stock options and issuance of directors' deferred stock	-	2	5,604	-	-	5,606	-	5,606
Net income	-	-	-	33,374	-	33,374	6,406	39,780
Change in unrealized loss on cash flow hedge	-	-	-	-	(690)	(690)	(242)	(932)
Preferred stock distributions:								
Series A	-	-	-	(6,000)	-	(6,000)	-	(6,000)
Series B	-	-	-	(5,355)	-	(5,355)	-	(5,355)
Common stock distributions	-	-	-	(21,189)	-	(21,189)	(7,467)	(28,656)
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)	-	-	-	(7,216)	-	(7,216)	(2,489)	(9,705)
Balance, December 31, 2012	\$179,328	\$ 201	\$246,557	\$(154,830)	\$(3,553)	\$267,703	\$39,586	\$307,289

The Notes to Financial Statements are an integral part of these statements.

(Dollars in thousands)	For the Year Ended December 31,		
	2012	2011	2010
Cash flows from operating activities:			
Net income	\$ 39,780	\$ 30,294	\$ 43,185
Adjustments to reconcile net income to net cash provided by operating activities:			
Change in fair value of derivatives	(36)	1,332	–
Gain on sale of property, discontinued operations	(4,510)	–	(3,591)
Gain on casualty settlement, continuing operations	(219)	(245)	(2,475)
Depreciation and amortization of deferred leasing costs	40,189	35,400	28,576
Amortization of deferred debt costs	1,576	1,547	1,467
Non cash compensation costs of stock grants and options	952	948	951
Provision for credit losses	1,151	1,883	1,337
(Increase) decrease in accounts receivable and accrued income	(3,240)	(5,291)	703
Additions to deferred leasing costs	(5,362)	(6,257)	(4,902)
(Increase) decrease in prepaid expenses	(54)	(844)	72
(Increase) decrease in other assets	9,573	(3,668)	(2,894)
Increase (decrease) in accounts payable, accrued expenses and other liabilities	(930)	1,478	1,069
Decrease in deferred income	(447)	(908)	(611)
Net cash provided by operating activities	78,423	55,669	62,887
Cash flows from investing activities:			
Acquisitions of real estate investments, net ⁽¹⁾	(34,050)	(170,100)	(32,747)
Additions to real estate investments	(12,680)	(11,624)	(6,573)
Additions to development and redevelopment projects	(7,913)	(20,780)	(68,867)
Proceeds from sale of properties	5,818	–	8,132
Proceeds from casualty settlement	1,952	1,004	1,816
Net cash used in investing activities	(46,873)	(201,500)	(98,239)
Cash flows from financing activities:			
Proceeds from mortgage notes payable	83,500	286,000	62,600
Repayments on mortgage notes payable	(117,595)	(82,685)	(53,691)
Proceeds from construction loans payable	–	13,410	49,505
Repayments on construction loans payable	–	(104,243)	–
Proceeds from revolving credit facility	38,000	16,000	–
Repayments on revolving credit facility	(8,000)	(8,000)	–
Additions to deferred debt costs	(2,199)	(1,445)	(1,054)
Proceeds from the issuance of:			
Common Stock	27,784	27,101	19,479
Partnership Units	–	49,589	–
Distributions to:			
Series A preferred stockholders	(8,000)	(8,000)	(8,000)
Series B preferred stockholders	(7,140)	(7,140)	(7,140)
Common stockholders	(28,135)	(27,062)	(26,186)
Noncontrolling interest	(9,955)	(8,339)	(7,800)
Net cash provided by (used in) financing activities	(31,740)	145,186	27,713
Net decrease in cash and cash equivalents	(190)	(645)	(7,639)
Cash and cash equivalents, beginning of year	12,323	12,968	20,607
Cash and cash equivalents, end of year	\$ 12,133	\$ 12,323	\$ 12,968
Supplemental disclosure of cash flow information:			
Cash paid for interest	\$ 48,302	\$ 42,948	\$ 40,678

Supplemental discussion of non-cash investing and financing activities:

(1) The 2010 real estate acquisition costs of \$32,747 are presented exclusive of a mortgage loan assumed of \$16,169 with a \$546 swap fair value.

The Notes to Financial Statements are an integral part of these statements.

1. ORGANIZATION, FORMATION, AND BASIS OF PRESENTATION

ORGANIZATION

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”). The Company 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.

FORMATION AND STRUCTURE OF COMPANY

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 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 mixed-used 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, developed and/or disposed of by the Company since January 1, 2010.

Name of Property	Location	Type	Year of Acquisition/Development/Disposal
ACQUISITIONS			
11503 Rockville Pike	Rockville, MD	Shopping Center	2010
Metro Pike Center	Rockville, MD	Shopping Center	2010
4469 Connecticut Ave	Washington, DC	Mixed-Use	2011
Kentlands Square II	Gaithersburg, MD	Shopping Center	2011
Severna Park MarketPlace	Severna Park, MD	Shopping Center	2011
Cranberry Square	Westminster, MD	Shopping Center	2011
1500 Rockville Pike	Rockville, MD	Shopping Center	2012
5541 Nicholson Lane	Rockville, MD	Shopping Center	2012
DEVELOPMENTS			
Clarendon Center North	Arlington, VA	Mixed-Use	2010/2011
Clarendon Center South	Arlington, VA	Mixed-Use	2010/2011
DISPOSITIONS			
Lexington	Lexington, KY	Shopping Center	2010
West Park	Oklahoma City, OK	Shopping Center	2012
Belvedere	Baltimore, MD	Shopping Center	2012

As of December 31, 2012, the Company's properties (the "Current Portfolio Properties") consisted of 50 shopping center properties (the "Shopping Centers"), seven mixed-use properties which are comprised of office, retail and multi-family residential uses (the "Mixed-Use Properties") and two (non-operating) development properties.

BASIS OF PRESENTATION

The accompanying financial statements are presented on the historical cost basis of The Saul Organization because of affiliated ownership and common management and because the assets and liabilities were the subject of a business combination with the Operating Partnership, the Subsidiary Partnerships and Saul Centers, all newly formed entities with no prior operations.

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 mixed-use properties, primarily in the Washington, DC/Baltimore metropolitan area. Because the properties are located primarily in the Washington, DC/Baltimore metropolitan area, a disproportionate economic downturn in the local economy would have a greater negative impact on our overall financial performance than on the overall financial performance of a company with a portfolio that is more geographically diverse. A majority of the Shopping Centers are anchored by several major tenants. As of December 31, 2012, 33 of the Shopping Centers were anchored by a grocery store and offer primarily day-to-day necessities and services. Two retail tenants, Giant Food (5.0%), a tenant at ten Shopping Centers, and Safeway (2.7%), a tenant at eight Shopping Centers, individually accounted for more than 2.5% of the Company's total revenue for the year ended December 31, 2012.

PRINCIPLES OF CONSOLIDATION

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

USE OF ESTIMATES

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

REAL ESTATE INVESTMENT PROPERTIES

The Company purchases real estate investment properties from time to time and records assets acquired and liabilities assumed, including land, buildings, and intangibles related to in-place leases and customer relationships, based on their fair values. The fair value of buildings generally is determined as if the buildings were vacant upon acquisition and then subsequently leased at market rental rates and considers the present value of all cash flows expected to be generated by the property including an initial lease up period. From time to time the Company may purchase a property, for future development purposes. The property may be improved with an existing structure that would be demolished as part of the development. In such cases, the fair value of the building may be determined based only on existing leases and not include estimated cash flows related to future leases. 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 taking into consideration the remaining contractual lease period, renewal periods, and the likelihood of the tenant exercising its renewal options. The fair value of a below market lease component is recorded as deferred income and accreted 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 values of the intangibles are amortized over the lives of the customer relationships. The Company has never recorded a customer relationship intangible asset. Acquisition-related transaction costs are expensed as incurred.

If there is an event or change in circumstance that indicates a potential impairment in the value of a real estate investment property, the Company prepares an analysis to determine whether the carrying value of the real estate investment property exceeds 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 the 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 fair 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 in 2012, 2011, or 2010.

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 totaled \$42,000, \$1.9 million, and \$7.2 million during 2012, 2011, and 2010, respectively. Commercial development projects are 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. Multi-family residential development projects are considered substantially complete and available for occupancy upon receipt of the certificate of occupancy from the appropriate licensing authority. 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 generally between 35 and 50 years for base buildings, or a shorter period if management determines that the building has a shorter useful life, and up to 20 years for

certain other improvements that extend the useful lives. Leasehold improvements expenditures are capitalized when certain criteria are met, including when the Company supervises 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 improvement, using the straight-line method. Depreciation expense and amortization of leasehold improvements for the years ended December 31, 2012, 2011, and 2010, was \$40.1 million, \$35.3 million, and \$28.4 million, respectively. Repairs and maintenance expense totaled \$9.3 million, \$10.9 million, and \$12.0 million for 2012, 2011, and 2010, respectively, and is included in property operating expenses in the accompanying consolidated financial statements.

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 commercial leases and amounts attributed to in place leases associated with acquired properties. Leasing related activities include evaluating the prospective tenant's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating lease terms, preparing lease documents and closing the transaction. Unamortized deferred costs are charged to expense if the applicable lease is terminated prior to expiration of the initial lease term. Deferred leasing costs are amortized over the term of the lease or remaining term of acquired leases. Collectively, deferred leasing costs totaled \$26.1 million and \$25.9 million, net of accumulated amortization of approximately \$16.2 million and \$14.7 million, as of December 31, 2012 and 2011, respectively. Amortization expense, included in depreciation and amortization in the consolidated statements of operations, totaled approximately \$5.6 million, \$4.8 million, and \$3.7 million, for the years ended December 31, 2012, 2011, and 2010, respectively.

CONSTRUCTION IN PROGRESS

Construction in progress includes preconstruction and development costs of active projects. Preconstruction costs 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 totaled \$2.3 million and \$1.1 million, respectively, as of December 31, 2012 and 2011.

ACCOUNTS RECEIVABLE AND ACCRUED INCOME

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 consolidated financial statements are shown net of an allowance for doubtful accounts of \$1.2 million and \$671,000, at December 31, 2012 and 2011, respectively.

ALLOWANCE FOR DOUBTFUL ACCOUNTS			
	For the Year Ended December 31,		
<i>(In thousands)</i>	2012	2011	2010
Beginning Balance	\$ 671	\$ 898	\$1,265
Provision for Credit Losses	1,160	1,883	1,337
Charge-offs	(623)	(2,110)	(1,704)
Ending Balance	\$ 1,208	\$ 671	\$ 898

In addition to rents due currently, accounts receivable also includes \$34.4 million and \$31.0 million, at December 31, 2012 and 2011, respectively, net of allowance for doubtful accounts totaling \$92,000 and \$63,000, respectively, representing minimum rental income accrued on a straight-line basis to be paid by tenants over the remaining term of their respective leases.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include short-term investments. Short-term investments include money market accounts and other investments which generally mature within three months, measured from the acquisition date, and/or are readily convertible to cash. Substantially all of the Company's cash balances at December 31, 2012 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 \$7.7 million and \$7.1 million, net of accumulated amortization of \$3.8 million and \$6.9 million at December 31, 2012 and 2011, 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.

DERIVATIVE FINANCIAL INSTRUMENTS

The Company may, when appropriate, employ derivative instruments, such as interest-rate swaps, to mitigate the risk of interest rate fluctuations. The Company does not enter into derivative or other financial instruments 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 qualify, the Company may designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge or a cash flow hedge. Derivative instruments that are designated as a hedge are evaluated to ensure they continue to qualify for hedge accounting. The effective portion of any 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 the change in fair value of a derivative instrument is immediately recognized in earnings. For derivative instruments that do not meet the criteria for hedge accounting, or that qualify and are not designated, changes in fair value are immediately recognized in earnings.

DISCONTINUED OPERATIONS

During 2012, the Company sold its West Park and Belvedere properties for \$2.0 million and \$4.0 million and recognized gains of \$1.1 million and \$3.4 million, respectively. During 2010, the Company sold its Lexington property for \$8.1 million and recognized a gain of \$3.6 million. The results of operations of West Park and Belvedere for the years ended December 31, 2012, 2011 and 2010 and of the Lexington property for the year ended December 31, 2010 are included in the statements of operations as "Loss from operations of property sold." The Company has no other discontinued operations.

REVENUE RECOGNITION

Rental and interest income are 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 stepped increases, income is recognized on a straight-line basis. Expense recoveries represent a portion of property operating expenses billed to the tenants, including common area maintenance, real estate taxes and other recoverable costs. Expense recoveries are recognized in the period in which 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.

As of December 31, 2012, the Company had no material unrecognized tax benefits and there exist no potentially significant unrecognized tax benefits which are reasonably expected to occur within the next twelve months. The Company recognizes penalties and interest accrued related to unrecognized tax benefits, if any, as general and administrative expense. No penalties and interest have been accrued in years 2012, 2011, and 2010. The tax basis of the Company's real estate investments was approximately \$1.1 billion, as of December 31, 2012 and 2011. With few exceptions, the Company is no longer subject to U.S. federal, state, and local tax examinations by tax authorities for years before 2007.

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 terminates 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 separation 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 December 31, 2012, 220,500 shares are in 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 for each of the years ended December 31, 2012, 2011, and 2010. The shares were valued at the closing stock price on the dates the shares were awarded and included in general and administrative expenses in the total amounts of \$110,000, \$109,000, and \$101,000, for the years ended December 31, 2012, 2011, and 2010, respectively.

NONCONTROLLING INTEREST

Saul Centers is the sole general partner of the Operating Partnership, owning a 74.4% common interest as of December 31, 2012. Noncontrolling interest in the Operating Partnership is comprised of limited partnership units owned by The Saul Organization. Noncontrolling interest 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 reflected on the consolidated statements of operations represents 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 anti-dilutive. For the years ended December 31, 2012, 2011, and 2010, certain options are dilutive because the average share price of the Company's common stock exceeded the exercise prices. The treasury stock method was used to measure the effect of the dilution.

BASIC AND DILUTED SHARES OUTSTANDING			
<i>(In thousands)</i>	December 31		
	2012	2011	2010
Weighted average common shares outstanding – Basic	19,649	18,888	18,267
Effect of dilutive options	51	61	110
Weighted average common shares outstanding – Diluted	19,700	18,949	18,377
Average Share Price	\$40.94	\$39.39	\$40.87

LEGAL CONTINGENCIES

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business, which are generally covered by insurance. Upon determination that a loss is probable to occur and can be reasonably estimated, the estimated amount of the loss is recorded in the financial statements.

RECLASSIFICATIONS

Certain reclassifications have been made to prior year and prior quarter information to conform to the presentation used for the three-months and year ended December 31, 2012.

3. REAL ESTATE ACQUIRED

11503 ROCKVILLE PIKE

On October 1, 2010, the Company purchased for \$15.1 million a retail property located in Rockville, Maryland, and incurred acquisition costs of \$0.5 million.

METRO PIKE CENTER

On December 17, 2010, the Company purchased for \$33.6 million (including the assumption of a \$16.2 million mortgage loan and a related interest-rate swap with a value of \$0.5 million) the Metro Pike Center located in Rockville, Maryland, and incurred acquisition costs of \$0.7 million. As of the date of acquisition, management determined the fair value of the mortgage loan equaled its outstanding balance because the terms of the loan were market terms.

4469 CONNECTICUT AVENUE

In February 2011, the Company purchased for \$1.6 million 4469 Connecticut Avenue, a one retail space property, currently unleased, located adjacent to Van Ness Square in northwest Washington, DC and incurred acquisition costs of \$74,000.

KENTLANDS SQUARE II

In September 2011, the Company purchased for \$74.5 million Kentlands Square II, a retail property located adjacent to the Company's Kentlands Square I and Kentlands Place shopping centers in Gaithersburg, Maryland, and incurred acquisition costs of \$1.1 million.

SEVERNA PARK MARKETPLACE

In September 2011, the Company purchased for \$61.0 million Severna Park Marketplace, a retail property located in Severna Park, Maryland, and incurred acquisition costs of \$0.8 million.

CRANBERRY SQUARE

In September 2011, the Company purchased for \$33.0 million Cranberry Square, a retail property located in Westminster, Maryland, and incurred acquisition costs of \$0.5 million.

1500 ROCKVILLE PIKE

In December 2012, the Company purchased for \$22.4 million 1500 Rockville Pike, a retail property located in Rockville, Maryland, and incurred acquisition costs of \$0.6 million.

5541 NICHOLSON LANE

In December 2012, the Company purchased for \$11.7 million 5541 Nicholson Lane, a retail property located in Rockville, Maryland, and incurred acquisition costs of \$0.5 million.

The revenue and expenses of 1500 Rockville Pike and 5541 Nicholson Lane have been included in the Consolidated Statements of Operations for the period subsequent to acquisition. Revenue and earnings (defined as revenue less the sum of operating expenses, provision for credit losses and real estate taxes, all arising from the operation of a property) totaled \$101,000 and \$14,000, respectively, from acquisition through December 31, 2012. The proforma results for the year ended December 31, 2012 and 2011 have been prepared for comparative purposes only and do not purport to be indicative of the results of operations that would have actually occurred had the transaction taken place on January 1, 2011, or of future results of operations. The following table shows proforma revenue and earnings of the Company assuming the acquisitions occurred as of January 1, 2011.

<i>(In thousands)</i>	Year ended December 31	
	2012	2011
Revenue	\$ 191,866	\$ 175,262
Earnings	144,320	129,981

ALLOCATION OF PURCHASE PRICE OF REAL ESTATE ACQUIRED

The Company allocates the purchase price of real estate investment properties to various components, such as land, buildings and intangibles related to in-place leases and customer relationships, based on their fair values. See Note 2. Summary of Significant Accounting Policies-Real Estate Investment Properties.

During 2012, the Company purchased two properties at an aggregate cost of \$34.1 million and incurred acquisition costs of \$1.1 million. Of the total purchase price, \$3.8 million was allocated to buildings, \$30.4 million was allocated to land, and \$0.5 million was allocated to in-place leases and \$0.7 million was

allocated to below market leases which is included in deferred income and is being accreted to income over the lives of the underlying leases, which is approximately 3.1 years.

During 2011, the Company purchased four properties at an aggregate cost of \$170.1 million, and incurred acquisition costs of \$2.5 million. Of the total purchase price, \$5.5 million was allocated to below market leases which is included in deferred income and is being accreted to income over the lives of the underlying leases, or approximately 10.9 years, and \$28,000 was allocated to above market leases, which is included as a deferred asset in accounts receivable and is being amortized against income over the lives of the underlying leases, which is approximately 4.1 years.

The allocation of the purchase prices for Severna Park Marketplace, Kentlands Square II, and Cranberry Square to the acquired assets and liabilities based on their fair values was as follows:

<i>(In thousands)</i>	Severna			Three Property Total
	Kentlands Square II	Park Marketplace	Cranberry Square	
Land	\$ 20,500	\$ 12,700	\$ 6,700	\$ 39,900
Buildings	51,973	50,554	24,878	127,405
In-Place Leases	2,697	2,433	1,499	6,629
Above Market Rents	6	4	18	28
Below Market Rents	(676)	(4,691)	(95)	(5,462)
Total Purchase Price	\$ 74,500	\$ 61,000	\$ 33,000	\$ 168,500

The gross carrying amount of lease intangible assets included in deferred leasing costs as of December 31, 2012 and 2011 was \$21.9 million and \$21.4 million, respectively, and accumulated amortization was \$14.7 million and \$12.7 million, respectively. Amortization expense totaled \$2.0 million, \$1.3 million and \$747,000, for the years ended December 31, 2012, 2011, and 2010, respectively. The gross carrying amount of below market lease intangible liabilities included in deferred income as of December 31, 2012 and 2011 was \$24.8 million and \$24.1 million, respectively, and accumulated amortization was \$8.3 million and \$6.7 million, respectively. Accretion income totaled \$1.6 million, \$1.2 million, and \$1.1 million, for the years ended December 31, 2012, 2011, and 2010, respectively. The gross carrying amount of above market lease intangible assets included in accounts receivable as of December 31, 2012 and 2011 was \$1.0 million and \$1.0 million, respectively, and accumulated amortization was \$930,000 and \$870,000, respectively. Amortization expense totaled \$60,000, \$62,000, and \$62,000, for the years ended December 31, 2012, 2011, and 2010, respectively.

As of December 31, 2012, scheduled amortization of intangible assets and deferred income related to in place leases is as follows:

AMORTIZATION OF INTANGIBLE ASSETS AND DEFERRED INCOME RELATED TO IN-PLACE LEASES			
<i>(In thousands)</i>	Lease acquisition costs	Above market leases	Below market leases
	2013	\$ 1,957	\$ 45
2014	1,066	21	1,482
2015	721	3	1,182
2016	566	1	1,116
2017	517	–	1,095
Thereafter	2,403	–	9,933
Total	\$ 7,230	\$ 70	\$ 16,502

4. NONCONTROLLING INTEREST - HOLDERS OF CONVERTIBLE LIMITED PARTNERSHIP UNITS IN THE OPERATING PARTNERSHIP

The Saul Organization holds a 25.6% limited partnership interest in the Operating Partnership represented by 6,914,000 limited partnership units, as of December 31, 2012. The 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 December 31, 2012, 987,000 units were eligible for conversion.

The impact of The Saul Organization's 25.6% 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 years ended December 31, 2012, 2011, and 2010, were 26,613,900, 24,739,700, and 23,793,000, respectively.

5. MORTGAGE NOTES PAYABLE, REVOLVING CREDIT FACILITY, INTEREST EXPENSE AND AMORTIZATION OF DEFERRED DEBT COSTS

At December 31, 2012, outstanding debt totaled \$827.8 million, of which \$774.9 million was fixed rate debt and \$52.9 million was variable rate debt. The Company's outstanding debt totaled \$831.9 million at December 31, 2011, of which \$808.8 million was fixed rate debt and \$23.1 million was variable rate debt. At December 31, 2012, the Company had a \$175.0 million unsecured revolving credit facility, which can be used for working capital, property acquisitions or development projects, under which \$38.0 million was outstanding. The revolving credit facility matures on May 20, 2016, 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 December 31, 2012, approximately \$136.8 million was available under the line and approximately \$224,000 was committed for letters of credit. The interest rate under the facility is based on the Company's leverage and is the sum of LIBOR and a margin ranging from 160 basis points to 250 basis points. As of December 31, 2012, the margin was 1.90%.

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 bank term loan (approximately \$7.5 million of the \$14.9 million outstanding at December 31, 2012). The fixed-rate notes payable are all non-recourse debt except for \$3.9 million of the Great Falls Center mortgage, 25% of the Metro Pike Center loan (approximately \$3.7 million of the \$15.7 million outstanding at December 31, 2012), and \$27.6 million of the Clarendon Center mortgage which will be eliminated upon the achievement of certain leasing and debt service covenants which are guaranteed by Saul Centers.

On June 29, 2010, the Company closed on a new 10-year mortgage loan in the amount of \$45.6 million, 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. In conjunction with the financing, the Company entered into an interest rate swap agreement with a \$45.6 million notional amount to manage the interest rate risk associated with the above \$45.6 million 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%. The Company has designated this agreement as a cash flow hedge for accounting purposes. The Company, therefore, will recognize interest expense on the variable-rate debt at

the effective fixed rate of 5.83%. The Company tests the hedge for effectiveness on a quarterly basis. On a combined basis, the loan and the interest-rate swap require 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 \$34.8 million at maturity.

Immediately prior to the refinancing, Thruway was one of nine properties securing debt included in a collateralized mortgage-backed security (CMBS) with an outstanding balance of \$108.3 million, an interest rate of 7.67% and due to mature October 2012. In order to release Thruway, the Company defeased \$30.2 million of the outstanding balance at a cost of approximately \$4.4 million, using proceeds from the new mortgage financing.

On August 24, 2010, the Company entered into an amendment to its Northrock construction loan to provide an option to extend the loan for two years. The extension is available at the Company's option subject to notice to the bank, and to a principal repayment in an amount required to cause property operating income to meet certain debt service coverage levels.

On December 9, 2010, the Company closed on a new 15-year, fixed-rate mortgage loan in the amount of \$17.0 million secured by Ravenwood. The loan matures January 2026, requires monthly interest and principal payments of \$111,409 based upon a fixed interest rate of 6.18% and a 25-year principal amortization and requires a final principal payment of approximately \$10.1 million at maturity.

Immediately prior to the refinancing, Ravenwood was one of eight remaining properties securing debt included in a CMBS with an outstanding balance of \$76.3 million, an interest rate of 7.67% and due to mature October 2012. In order to release Ravenwood, the Company defeased \$7.8 million of the outstanding balance at a cost of approximately \$900,000, using proceeds from the new mortgage financing.

On December 17, 2010, the Company purchased Metro Pike Center, a 62,000 square foot retail property located in Rockville, Maryland. In conjunction with the acquisition, the Company assumed a mortgage loan with a principal balance of \$16.2 million. The loan matures June 30, 2013, bears interest at a variable rate equal to the sum of one-month LIBOR and 245 basis points. In conjunction with the loan assumption, the Company assumed a corresponding interest rate swap agreement with a \$16.2 million notional amount to manage the interest rate risk associated with the variable-rate mortgage debt. The swap agreement was effective at closing, terminates on June 30, 2013 and effectively fixes the interest rate on the mortgage debt at 4.67%. Although the swap is an effective hedge of the loan, the Company elected not to designate this agreement as a hedge for accounting purposes. Interest expense on the loan is recognized at its variable interest rate. The swap agreement is carried at its fair value with changes in fair value recognized in change in fair value of

derivatives in the Consolidated Statements of Operations as they occur. On a combined basis, the loan and the interest-rate swap require interest-only payments of \$62,925, based upon an assumed interest rate of 4.67% until August 1, 2011, followed by equal monthly payments of \$86,000 based upon a 25-year amortization schedule and a final payment of \$15.6 million at loan maturity.

On March 23, 2011, the Company closed on a 15-year non-recourse mortgage loan in the amount of \$125.0 million, secured by Clarendon Center. The loan matures April 5, 2026, bears interest at a fixed rate of 5.31%, requires equal monthly principal and interest payments of \$753,491, based upon a 25-year principal amortization, and requires a final principal payment of approximately \$70.5 million at maturity. Proceeds from the loan were used to repay \$104.2 million outstanding on the Clarendon Center construction loan.

On September 23, 2011, the Company closed on a 15-year non-recourse mortgage loan in the amount of \$38.0 million, secured by Severna Park MarketPlace. The loan matures October 1, 2026, bears interest at a fixed rate of 4.30%, requires equal monthly principal and interest payments of \$206,926, based upon a 25-year principal amortization, and requires a final principal payment of approximately \$20.3 million at maturity. Proceeds from the loan were used to purchase Severna Park MarketPlace.

Also on September 23, 2011, the Company closed on two six-month bridge financing loans in the total amount of \$60.0 million, secured by Kentlands Square II and Cranberry Square. Proceeds from the loans were used to purchase Kentlands Square II and Cranberry Square.

On October 5, 2011, the Company closed on a new 15-year non-recourse mortgage loan in the amount of \$43.0 million, secured by Kentlands Square II. The loan matures November 5, 2026, bears interest at a fixed rate of 4.53%, requires equal monthly principal and interest payments of \$239,741, based upon a 25-year principal amortization, and requires a final principal payment of approximately \$23.3 million at maturity. Proceeds from the loan were used to repay the \$40.0 million bridge financing used to acquire Kentlands Square II.

On November 6, 2011, the Company closed on a new 15-year non-recourse mortgage loan in the amount of \$20.0 million, secured by Cranberry Square. The loan matures December 1, 2026, bears interest at a fixed rate of 4.70%, requires equal monthly principal and interest payments of \$113,449, based upon a 25-year principal amortization, and requires a final principal payment of approximately \$10.9 million at maturity. Proceeds from the loan were used to repay the \$20.0 million bridge financing used to acquire Cranberry Square.

On April 11, 2012, the Company closed on a 15-year non-recourse mortgage loan in the amount of \$73.0 million secured by Seven Corners shopping center. The loan matures in May 2027, bears interest at a fixed rate of 5.84%, requires equal monthly principal and interest payments totaling \$463,226 based upon a 25-year amortization schedule and a final payment of \$42.5 million at maturity. Proceeds from the loan were used to pay-off the \$63 million remaining balance of existing debt secured by Seven Corners and six other shopping center properties, which was scheduled to mature in October 2012, and to provide cash of approximately \$10 million.

On April 26, 2012, the Company substituted the White Oak shopping center for Van Ness Square as collateral for one of its existing mortgage loans which allowed the Company to analyze the feasibility of repositioning Van Ness Square. The terms of the original loan, including its 8.11% interest rate, are unchanged and, in conjunction with the collateral substitution, the Company borrowed an additional \$10.5 million, also secured by White Oak. The new borrowing requires equal monthly payments based upon a fixed 4.90% interest rate and 25-year amortization schedule, and will mature in July 2024, coterminously with the original loan. The consolidated loan requires equal monthly payments based upon a blended fixed interest rate of 7.0% and will require a final payment of \$18.5 million at maturity.

On May 21, 2012, the Company replaced its existing unsecured revolving credit facility with a new \$175.0 million facility that expires on May 20, 2016. The facility, which provides working capital and funds for acquisitions, certain developments, redevelopments and letters of credit, may be extended for one year, at the Company's option, subject to the satisfaction of certain conditions. Loans under the facility bear interest at a rate equal to the sum of LIBOR and a margin, based on the Company's leverage ratio, ranging from 160 basis points to 250 basis points. Based on the leverage ratio of December 31, 2012, the margin was 190 basis points.

The following is a summary of notes payable as of December 31, 2012 and 2011:

NOTES PAYABLE				
(Dollars in thousands)	December 31,		Interest Rate *	Scheduled Maturity *
	2012	2011		
Fixed rate mortgages:	\$			
	– (a)	64,844	7.67%	Oct-2012
	– (b)	10,244	6.12%	Jan-2013
	– (c)	24,598	7.88%	Jan-2013
	15,750 (d)	16,032	4.67%	Jun-2013
	6,936 (e)	7,203	5.77%	Jul-2013
	13,875 (f)	14,335	5.40%	May-2014
	16,798 (g)	17,415	7.45%	Jun-2015
	34,373 (h)	35,435	6.01%	Feb-2018
	38,388 (i)	39,757	5.88%	Jan-2019
	12,418 (j)	12,860	5.76%	May-2019
	17,145 (k)	17,755	5.62%	Jul-2019
	17,040 (l)	17,627	5.79%	Sep-2019
	15,176 (m)	15,713	5.22%	Jan-2020
	11,421 (n)	11,670	5.60%	May-2020
	10,288 (o)	10,636	5.30%	Jun-2020
	43,424 (p)	44,333	5.83%	Jul-2020
	8,934 (q)	9,204	5.81%	Feb-2021
	6,359 (r)	6,477	6.01%	Aug-2021
	36,699 (s)	37,377	5.62%	Jun-2022
	11,129 (t)	11,317	6.08%	Sep-2022
	11,989 (u)	12,172	6.43%	Apr-2023
	16,247 (v)	16,858	6.28%	Feb-2024
	17,469 (w)	17,791	7.35%	Jun-2024
	15,140 (x)	15,409	7.60%	Jun-2024
	26,635 (y)	16,494	7.02%	Jul-2024
	31,709 (z)	32,281	7.45%	Jul-2024
	31,490 (aa)	32,044	7.30%	Jan-2025
	16,419 (bb)	16,731	6.18%	Jan-2026
	120,822 (cc)	123,372	5.31%	Apr-2026
	36,986 (dd)	37,858	4.30%	Oct-2026
	41,970 (ee)	42,923	4.53%	Nov-2026
	19,569 (ff)	20,000	4.70%	Dec-2026
	72,233 (gg)	–	5.84%	May-2027
Total fixed rate	774,831	808,765	5.82%	10.0 Years
Variable rate loans:				
Revolving credit facility	38,000 (hh)	8,000	LIBOR + 1.90%	May-2016
Northrock bank term loan	14,945 (ii)	15,106	LIBOR + 3.00%	May-2013
Total variable rate	52,945	23,106	2.80%	3.4 Years
Total notes payable	\$ 827,776	\$ 831,871	5.77%	9.7 Years

* Interest rate and scheduled maturity data presented as of December 31, 2012. Totals computed using weighted averages.

- (a) The loan was collateralized by seven shopping centers (Seven Corners, White Oak, Hampshire Langley, Great Eastern, Southside Plaza, Belvedere and Giant) and required equal monthly principal and interest payments of \$734,000 based upon a 25-year amortization schedule and a final payment of \$62.0 million at loan maturity. The loan was repaid in full in 2012.
- (b) The loan was collateralized by Smallwood Village Center and required equal monthly principal and interest payments of \$71,000 based upon a 30-year amortization schedule and a final payment of \$10.1 million at loan maturity. The loan was repaid in full in 2012.
- (c) The loan was collateralized by 601 Pennsylvania Avenue and required equal monthly principal and interest payments of \$294,000 based upon a 25-year amortization schedule and a final payment of \$23.0 million at loan maturity. The loan was repaid in full in 2012.
- (d) The loan, together with a corresponding interest-rate swap, was assumed with the December 17, 2010 acquisition of, and is collateralized by, Metro Pike Center. On a combined basis, the loan and the swap required interest only payments of \$63,000 until August 1, 2011, then equal monthly payments of \$86,000 based upon a 25-year amortization schedule and a final payment of \$15.6 million at loan maturity. Principal of \$282,000 was amortized during 2012.
- (e) The loan is collateralized by Cruse MarketPlace and requires equal monthly principal and interest payments of \$56,000 based upon an amortization schedule of approximately 24 years and a final payment of \$6.8 million at loan maturity. Principal of \$267,000 was amortized during 2012.
- (f) The loan is collateralized by Seabreeze Plaza and requires equal monthly principal and interest payments totaling \$102,000 based upon a weighted average 26-year amortization schedule and a final payment of \$13.3 million is due at loan maturity. Principal of \$460,000 was amortized during 2012.
- (g) The loan is collateralized by Shops at Fairfax and Boulevard shopping centers and requires equal monthly principal and interest payments totaling \$156,000 based upon a weighted average 23-year amortization schedule and a final payment of \$15.2 million is due at loan maturity. Principal of \$617,000 was amortized during 2012.
- (h) The loan is collateralized by Washington Square and requires equal monthly principal and interest payments of \$264,000 based upon a 27.5-year amortization schedule and a final payment of \$28.0 million at loan maturity. Principal of \$1.1 million was amortized during 2012.
- (i) The loan is collateralized by three shopping centers, Broadlands Village, The Glen and Kentlands Square I, and requires equal monthly principal and interest payments of \$306,000 based upon a 25-year amortization schedule and a final payment of \$28.4 million at loan maturity. Principal of \$1.4 million was amortized during 2012.
- (j) The loan is collateralized by Olde Forte Village and requires equal monthly principal and interest payments of \$98,000 based upon a 25-year amortization schedule and a final payment of \$9.0 million at loan maturity. Principal of \$442,000 was amortized during 2012.
- (k) The loan is collateralized by Countryside and requires equal monthly principal and interest payments of \$133,000 based upon a 25-year amortization schedule and a final payment of \$12.3 million at loan maturity. Principal of \$610,000 was amortized during 2012.
- (l) The loan is collateralized by Briggs Chaney MarketPlace and requires equal monthly principal and interest payments of \$133,000 based upon a 25-year amortization schedule and a final payment of \$12.2 million at loan maturity. Principal of \$587,000 was amortized during 2012.
- (m) The loan is collateralized by Shops at Monocacy and requires equal monthly principal and interest payments of \$112,000 based upon a 25-year amortization schedule and a final payment of \$10.6 million at loan maturity. Principal of \$537,000 was amortized during 2012.
- (n) The loan is collateralized by Boca Valley Plaza and requires equal monthly principal and interest payments of \$75,000 based upon a 30-year amortization schedule and a final payment of \$9.1 million at loan maturity. Principal of \$249,000 was amortized during 2012.
- (o) The loan is collateralized by Palm Springs Center and requires equal monthly principal and interest payments of \$75,000 based upon a 25-year amortization schedule and a final payment of \$7.1 million at loan maturity. Principal of \$348,000 was amortized during 2012.
- (p) The loan and a corresponding interest-rate swap closed on June 29, 2010 and are collateralized by Thruway. On a combined basis, the loan and the interest-rate swap require equal monthly principal and interest payments of \$289,000 based upon a 25-year amortization schedule and a final payment of \$34.8 million at loan maturity. Principal of \$909,000 was amortized during 2012.
- (q) The loan is collateralized by Jamestown Place and requires equal monthly principal and interest payments of \$66,000 based upon a 25-year amortization schedule and a final payment of \$6.1 million at loan maturity. Principal of \$270,000 was amortized during 2012.
- (r) The loan is collateralized by Hunt Club Corners and requires equal monthly principal and interest payments of \$42,000 based upon a 30-year amortization schedule and a final payment of \$5.0 million, at loan maturity. Principal of \$118,000 was amortized during 2012.
- (s) The loan is collateralized by Lansdowne Town Center and requires monthly principal and interest payments of \$230,000 based on a 30-year amortization schedule and a final payment of \$28.2 million at loan maturity. Principal of \$678,000 was amortized during 2012.
- (t) The loan is collateralized by Orchard Park and requires equal monthly principal and interest payments of \$73,000 based upon a 30-year amortization schedule and a final payment of \$8.6 million at loan maturity. Principal of \$188,000 was amortized during 2012.
- (u) The loan is collateralized by BJ's Wholesale and requires equal monthly principal and interest payments of \$80,000 based upon a 30-year amortization schedule and a final payment of \$9.3 million at loan maturity. Principal of \$183,000 was amortized during 2012.
- (v) The loan is collateralized by Great Falls shopping center. The loan consists of three notes which require equal monthly principal and interest payments of \$138,000 based upon a weighted average 26-year amortization schedule and a final payment of \$6.3 million at maturity. Principal of \$611,000 was amortized during 2012.
- (w) The loan is collateralized by Leesburg Pike and requires equal monthly principal and interest payments of \$135,000 based upon a 25-year amortization schedule and a final payment of \$11.5 million at loan maturity. Principal of \$322,000 was amortized during 2012.
- (x) The loan is collateralized by Village Center and requires equal monthly principal and interest payments of \$119,000 based upon a 25-year amortization schedule and a final payment of \$10.1 million at loan maturity. Principal of \$269,000 was amortized during 2012.
- (y) The loan is collateralized by White Oak and requires equal monthly principal and interest payments of \$193,000 based upon a 24.4 year weighted amortization schedule and a final payment of \$18.5 million at loan maturity. The loan was previously collateralized by Van Ness Square. During 2012, the Company substituted White Oak as the collateral and borrowed an additional \$10.5 million. Principal of \$359,000 was amortized during 2012.
- (z) The loan is collateralized by Avenel Business Park and requires equal monthly principal and interest payments of \$246,000 based upon a 25-year amortization schedule and a final payment of \$20.9 million at loan maturity. Principal of \$572,000 was amortized during 2012.
- (aa) The loan is collateralized by Ashburn Village and requires equal monthly principal and interest payments of \$240,000 based upon a 25-year amortization schedule and a final payment of \$20.5 million at loan maturity. Principal of \$554,000 was amortized during 2012.

- (bb) The loan is collateralized by Ravenwood and requires equal monthly principal and interest payments of \$111,000 based upon a 25-year amortization schedule and a final payment of \$10.1 million at loan maturity. Principal of \$312,000 was amortized during 2012.
- (cc) The loan is collateralized by Clarendon Center and requires equal monthly principal and interest payments of \$753,000 based upon a 25-year amortization schedule and a final payment of \$70.5 million at loan maturity. Principal of \$2.6 million was amortized during 2012.
- (dd) The loan is collateralized by Severna Park MarketPlace and requires equal monthly principal and interest payments of \$207,000 based upon a 25-year amortization schedule and a final payment of \$20.3 million at loan maturity. Principal of \$872,000 was amortized during 2012.
- (ee) The loan is collateralized by Kentlands Square II and requires equal monthly principal and interest payments of \$240,000 based upon a 25-year amortization schedule and a final payment of \$23.1 million at loan maturity. Principal of \$953,000 was amortized during 2012.

- (ff) The loan is collateralized by Cranberry Square and requires equal monthly principal and interest payments of \$113,000 based upon a 25-year amortization schedule and a final payment of \$10.9 million at loan maturity. Principal of \$431,000 was amortized during 2012.
- (gg) The loan in the original amount of \$73.0 million closed in May 2012, is collateralized by Seven Corners and requires equal monthly principal and interest payments of \$463,200 based upon a 25-year amortization schedule and a final payment of \$42.3 million at loan maturity. Principal of \$767,000 was amortized during 2012.
- (hh) The loan is a \$175.0 million unsecured revolving credit facility. Interest accrues at a rate equal to the sum of one-month LIBOR plus a spread of 1.90%. The line may be extended at the Company's option for one year with payment of a fee of 0.20%. Monthly payments, if required, are interest only and vary depending upon the amount outstanding and the applicable interest rate for any given month.
- (ii) The loan is collateralized by Northrock and requires monthly principal and interest payments of \$13,409 and a final payment of \$14.9 million at maturity. Principal of \$161,000 was amortized during 2012.

The carrying value of the properties collateralizing the mortgage notes payable totaled \$916.1 million and \$997.5 million, as of December 31, 2012 and 2011, respectively. The Company's credit facility requires the Company and its subsidiaries to maintain certain financial covenants, which are summarized below. The Company was in compliance as of December 31, 2012.

- maintain tangible net worth, as defined in the loan agreement, of at least \$503.3 million plus 80% of the Company's net equity proceeds received after May 2012;
- 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 2.0x on a trailing four-quarter basis (interest expense coverage);
- limit the amount of debt so that interest, scheduled principal amortization and preferred dividend coverage exceeds 1.3x on a trailing four-quarter basis (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.

Mortgage notes payable at December 31, 2012 and 2011, totaling \$51.0 million and \$99.4 million, respectively, are guaranteed by members of The Saul Organization. As of December 31, 2012, the scheduled maturities of all debt including scheduled principal amortization for years ended December 31, are as follows:

DEBT MATURITY SCHEDULE			
(In thousands)	Balloon Payments	Scheduled Principal Amortization	Total
2013	\$ 37,305	\$ 19,212	\$ 56,517
2014	13,218	19,677	32,895
2015	15,077	20,209	35,286
2016	38,000 ^(a)	21,058	59,058
2017	-	22,311	22,311
Thereafter	472,892	148,817	621,709
Total	\$ 576,492	\$ 251,284	\$ 827,776

(a) Includes \$38 million outstanding under the line of credit.

INTEREST EXPENSE AND AMORTIZATION OF DEFERRED DEBT COSTS			
(In thousands)	Year ended December 31,		
	2012	2011	2010
Interest incurred	\$ 48,010	\$45,673	\$40,528
Amortization of deferred debt costs	1,576	1,547	1,467
Capitalized interest	(42)	(1,896)	(7,196)
Total	\$ 49,544	\$45,324	\$34,799

Deferred debt costs capitalized in 2012 totaled \$2.2 million. No deferred debt costs were capitalized during 2011 and 2010.

6. LEASE AGREEMENTS

Lease income includes primarily base rent arising from noncancelable leases. Base rent (including straight-line rent) for the years ended December 31, 2012, 2011, and 2010, amounted to \$152.8 million, \$138.4 million, and \$126.2 million, respectively.

Future contractual payments under noncancelable leases for years ended December 31 (which exclude the effect of straight-line rents), are as follows:

FUTURE CONTRACTUAL PAYMENTS	
(In thousands)	
2013	\$ 146,293
2014	123,137
2015	104,558
2016	87,335
2017	70,306
Thereafter	310,790
Total	\$ 842,419

The majority of the leases provide for rental increases and expense recoveries based on fixed annual increases or increases in the Consumer Price Index and increases in operating expenses. The expense recoveries generally are payable in equal installments throughout the year based on estimates, with adjustments made in the succeeding year. Expense recoveries for the years ended December 31, 2012, 2011, and 2010, amounted to \$30.4 million, \$28.4 million, and \$29.5 million, respectively. In addition, certain retail leases provide for percentage rent based on sales in excess of the minimum specified in the tenant's lease. Percentage rent amounted to \$1.5 million, \$1.5 million, and \$1.5 million, for the years ended December 31, 2012, 2011, and 2010, respectively.

7. LONG-TERM LEASE OBLIGATIONS

Certain properties are subject to noncancelable long-term leases which apply to land underlying the Shopping Centers. Certain of the leases provide for periodic adjustments of the base annual rent and require the payment of real estate taxes on the underlying land. The leases will expire between 2058 and 2068.

Reflected in the accompanying consolidated financial statements is minimum ground rent expense of \$176,000, \$173,000, and \$169,000, for the years ended December 31, 2012, 2011, and 2010, respectively. The future minimum rental commitments under these ground leases are as follows:

GROUND LEASE RENTAL COMMITMENTS							
(In thousands)	Year ending December 31,						
	2013	2014	2015	2016	2017	Thereafter	Total
Beacon Center	\$ 60	\$ 60	\$ 60	\$ 60	\$ 60	\$ 2,660	\$ 2,960
Olney	56	56	56	56	56	3,873	4,153
Southdale	60	60	60	60	60	3,005	3,305
Total	\$ 176	\$ 176	\$ 176	\$ 176	\$ 176	\$ 9,538	\$10,418

In addition to the above, Flagship Center consists of two developed out parcels that are part of a larger adjacent community shopping center formerly owned by The Saul Organization and sold to an affiliate of a tenant in 1991. The Company has a 90-year ground leasehold interest which commenced in September 1991 with a minimum rent of one dollar per year. Countryside

shopping center was acquired in February, 2004. Because of certain land use considerations, approximately 3.4% of the underlying land is held under a 99-year ground lease. The lease requires the Company to pay minimum rent of one dollar per year as well as its pro-rata share of the real estate taxes.

The Company's corporate headquarters space is leased by a member of The Saul Organization. The lease commenced in March 2002 was extended in 2012 for five years, and 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 years ended December 31, 2012, 2011, and 2010 was \$850,000, \$945,000, and \$893,000, respectively. Expenses arising from the lease are included in general and administrative expense (see Note 9 – Related Party Transactions).

8. STOCKHOLDERS' EQUITY AND NONCONTROLLING INTEREST

The Consolidated Statements of Operations for the years ended December 31, 2012, 2011, and 2010 reflect noncontrolling interest of \$6.4 million, \$3.6 million, and \$6.4 million, respectively, representing The Saul Organization's share of the net income for the year.

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

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.

In September 2011, in connection with the acquisition of three shopping centers, the Company and the Operating Partnership issued to members of The Saul Organization 186,968 shares of

the Company's common stock, par value \$0.01 per share ("Shares") and 1,497,814 units of limited partnership interests in the Operating Partnership ("Units") with an aggregate value of \$55.8 million. The price of the Shares and Units was equal to the average closing prices of the Company's common stock listed on the New York Stock Exchange for the five trading days ending with the trading day immediately preceding the date of closing of the property acquisition.

9. RELATED PARTY TRANSACTIONS

The Chairman and Chief Executive Officer, the President, the Executive Vice President-Real Estate 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 \$379,000, \$378,000, and \$358,000, for 2012, 2011, and 2010, 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 years ended December 31, 2012, 2011, and 2010, the Company contributed three times the amount deferred by employees. The Company's expense, included in general and administrative expense, totaled \$238,000, \$231,000, and \$213,000, for the years ended December 31, 2012, 2011, and 2010, respectively. All amounts deferred by employees and the Company are fully vested. The cumulative unfunded liability under this plan was \$2.2 million and \$1.9 million, at December 31, 2012 and 2011, respectively, and is included in accounts payable, accrued expenses and other liabilities in the consolidated balance sheets.

The Company has entered into a shared services agreement (the "Agreement") with The Saul Organization that provides for the sharing of certain personnel and ancillary functions such as computer hardware, software, and support services and certain

direct and indirect administrative personnel. The method for determining the cost of the shared services is provided for in the Agreement and is based upon head count, estimates of usage or estimates of time incurred, as applicable. Senior management has determined that the final allocations of shared costs are reasonable. The terms of the Agreement and the payments made thereunder 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 years ended December 31, 2012, 2011, and 2010, which included rental expense for the Company's headquarters lease (see Note 7. Long Term Lease Obligations), totaled \$6.0 million, \$6.1 million, and \$6.5 million, respectively. The amounts are expensed when incurred and are primarily reported as general and administrative expenses or capitalized to specific development projects in these consolidated financial statements. As of December 31, 2012 and 2011, accounts payable, accrued expenses and other liabilities included \$499,000 and \$560,000, respectively, representing billings due to The Saul Organization for the Company's share of these ancillary costs and expenses.

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 counter-signature fees in connection with the Company's insurance program. Such commissions and fees amounted to approximately \$372,000, \$341,000, and \$324,000, for the years ended December 31, 2012, 2011, and 2010, respectively.

Effective as of September 4, 2012, the Company entered into a consulting agreement with B. F. Saul III, the Company's former president, whereby Mr. Saul III will provide certain consulting services to the Company as an independent contractor. Under the consulting agreement, Mr. Saul III will be paid at a rate of \$60,000 per month. The consulting agreement includes certain noncompete, nonsolicitation and nondisclosure covenants, and has a term of up to two years, although the consulting agreement is terminable by the Company at any time. During 2012, such consulting fees totaled \$225,000.

10. STOCK OPTION PLAN

The Company established a stock option plan in 1993 (the "1993 Plan") for the purpose of attracting and retaining executive officers and other key personnel. The 1993 Plan provides for grants of options to purchase up to 400,000 shares of common stock. The 1993 Plan authorizes the Compensation Committee of the Board of Directors to grant options at an exercise price which may not be less than the market value of the common stock on the date the option is granted. On May 23, 2003, the Compensation Committee granted options to purchase a total of 220,000 shares (80,000 shares from incentive stock options and 140,000 shares from nonqualified stock options) to six

Company officers (the "2003 Options"). Following the grant of the 2003 Options, no additional shares remained for issuance under the 1993 Plan. The 2003 Options vested 25% per year over four years and have a term of ten years, subject to earlier expiration upon termination of employment. The exercise price of \$24.91 per share was the closing market price of the Company's common stock on the date of the award.

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"). The Amended 2004 Plan, which terminates in April 2018, provides for grants of options to purchase up to 1,000,000 shares of common stock as well as grants of up to 200,000 shares of common stock to directors. The Amended 2004 Plan authorizes the Compensation Committee of the Board of Directors to grant options at an exercise price which may not be less than the market value of the common stock on the date the option is granted.

Effective April 26, 2004, the Compensation Committee granted options to purchase a total of 152,500 shares (27,500 shares from incentive stock options and 125,000 shares from nonqualified stock options) to eleven Company officers and to the twelve Company directors (the "2004 Options"), which expire on April 25, 2014. The officers' 2004 Options vested 25% per year over four years and are subject to early expiration upon termination of employment. The directors' options were immediately exercisable. The exercise price of \$25.78 per share was the closing market price of the Company's common stock on the date of the award. Using the Black-Scholes model, the Company determined the total fair value of the 2004 Options to be \$360,000, of which \$293,000 and \$67,000 were the values assigned to the officer options and director options, respectively. Because the directors' options vested immediately, the entire \$67,000 was expensed as of the date of grant. The expense of the officers' options was recognized as compensation expense monthly during the four years the options vested.

Effective May 6, 2005, the Compensation Committee granted options to purchase a total of 162,500 shares (35,500 shares from incentive stock options and 127,000 shares from nonqualified stock options) to twelve Company officers and to twelve Company directors (the "2005 Options"), which expire on May 5, 2015. The officers' 2005 Options vested 25% per year over four years and are subject to early expiration upon termination of employment. The directors' options were immediately exercisable. The exercise price of \$33.22 per share was the closing market price of the Company's common stock on the date of the award. Using the Black-Scholes model, the Company determined the total fair value of the 2005 Options to be \$484,500, of which \$413,400 and \$71,100 were the values assigned to the officer options and director options, respectively.

Because the directors' options vested immediately, the entire \$71,100 was expensed as of the date of grant. The expense of the officers' options was recognized as compensation expense monthly during the four years the options vested.

Effective May 1, 2006, the Compensation Committee granted options to purchase a total of 30,000 shares (all nonqualified stock options) to twelve Company directors (the "2006 Options"), which were immediately exercisable and expire on April 30, 2016. The exercise price of \$40.35 per share was the closing market price of the Company's common stock on the date of the award. Using the Black-Scholes model, the Company determined the total fair value of the 2006 Options to be \$143,400. Because the directors' options vested immediately, the entire \$143,400 was expensed as of the date of grant. No options were granted to the Company's officers in 2006.

Effective April 27, 2007, the Compensation Committee granted options to purchase a total of 165,000 shares (27,560 shares from incentive stock options and 137,440 shares from nonqualified stock options) to thirteen Company officers and twelve Company Directors (the "2007 options"), which expire on April 26, 2017. The officers' 2007 Options vest 25% per year over four years and are subject to early expiration upon termination of employment. The directors' options were immediately exercisable. The exercise price of \$54.17 per share was the closing market price of the Company's common stock on the date of award. Using the Black-Scholes model, the Company determined the total fair value of the 2007 Options to be \$1.5 million, of which \$1.3 million and \$285,300 were the values assigned to the officer options and director options, respectively. Because the directors' options vested immediately, the entire \$285,300 was expensed as of the date of grant. The expense for the officers' options was recognized as compensation expense monthly during the four years the options vested.

Effective April 25, 2008, the Compensation Committee granted options to purchase a total of 30,000 shares (all nonqualified stock options) to twelve Company directors (the "2008 Options"), which were immediately exercisable and expire on April 24, 2018. The exercise price of \$50.15 per share was the closing market price of the Company's common stock on the date of the award. Using the Black-Scholes model, the Company determined the total fair value of the 2008 Options to be \$254,700. Because the directors' options vest immediately, the entire \$254,700 was expensed as of the date of grant. No options were granted to the Company's officers in 2008.

Effective April 24, 2009, the Compensation Committee granted options to purchase a total of 32,500 shares (all nonqualified stock options) to thirteen Company directors (the "2009 Options"), which were immediately exercisable and expire on April 23, 2019. The exercise price of \$32.68 per share was the closing market price of the Company's common stock on the date of the award. Using the Black-Scholes model, the Company

determined the total fair value of the 2009 Options to be \$222,950. Because the directors' options vested immediately, the entire \$222,950 was expensed as of the date of grant. No options were granted to the Company's officers in 2009.

Effective May 7, 2010, the Compensation Committee granted options to purchase a total of 32,500 shares (all nonqualified stock options) to thirteen Company directors (the "2010 Options"), which were immediately exercisable and expire on May 6, 2020. The exercise price of \$38.76 per share was the closing market price of the Company's common stock on the date of the award. Using the Black-Scholes model, the Company determined the total fair value of the 2010 Options to be \$287,950. Because the directors' options vested immediately, the entire \$287,950 was expensed as of the date of grant. No options were granted to the Company's officers in 2010.

Effective May 13, 2011, the Compensation Committee granted options to purchase a total of 195,000 shares (65,300 shares from incentive stock options and 129,700 shares from nonqualified stock options) to 15 Company officers and 13 Company Directors (the "2011 options"), which expire on May 12, 2021. The officers' 2011 Options vest 25% per year over four years and are subject to early expiration upon termination of employment. The directors' 2011 options were immediately exercisable. The exercise price of \$41.82 per share was the closing market price of the Company's common stock on the date of award. Using the Black-Scholes model, the Company determined the total fair value of the 2011 Options to be \$1.6 million, of which \$1.3 million and \$297,000 were assigned to the officer options and director options, respectively. Because the directors' options vested immediately, the entire \$297,000 was expensed as of the date of grant. The expense for the officers' options is being recognized as compensation expense monthly during the four years the options vest.

Effective May 4, 2012, the Compensation Committee granted options to purchase a total of 277,500 shares (26,157 shares from incentive stock options and 251,343 shares from nonqualified stock options) to 15 Company officers and 14 Company Directors (the "2012 options"), which expire on May 3, 2022. The officers' 2012 Options vest 25% per year over four years and are subject to early expiration upon termination of employment. The directors' 2012 options were immediately exercisable. The exercise price of \$39.29 per share was the closing market price of the Company's common stock on the date of award. Using the Black-Scholes model, the Company determined the total fair value of the 2012 Options to be \$1.7 million, of which \$1.44 million and \$244,000 were assigned to the officer options and director options, respectively. Because the directors' options vested immediately, the entire \$244,000 was expensed as of the date of grant. The expense for the officers' options is being recognized as compensation expense monthly during the four years the options vest.

The following table summarizes the amount and activity of each grant, the total value and variables used in the computation and the amount expensed and included in general and administrative expense in the Consolidated Statements of Operations for the years ended December 31, 2012, 2011 and 2010:

STOCK OPTIONS ISSUED TO DIRECTORS										
Grant date	04/26/2004	05/06/2005	05/01/2006	04/27/2007	04/25/2008	04/24/2009	05/07/2010	05/13/2011	5/4/2012	Subtotals
Total grant	30,000	30,000	30,000	30,000	30,000	32,500	32,500	32,500	35,000	282,500
Vested	30,000	30,000	30,000	30,000	30,000	32,500	32,500	32,500	35,000	282,500
Exercised	21,200	17,500	2,500	-	-	10,000	2,500	2,500	2,500	58,700
Forfeited	-	-	2,500	5,000	5,000	-	2,500	2,500	-	17,500
Exercisable at										
December 31, 2012	8,800	12,500	25,000	25,000	25,000	22,500	27,500	27,500	32,500	206,300
Remaining unexercised	8,800	12,500	25,000	25,000	25,000	22,500	27,500	27,500	32,500	206,300
Exercise price	\$ 25.78	\$ 33.22	\$ 40.35	\$ 54.17	\$ 50.15	\$ 32.68	\$ 38.76	\$ 41.82	\$ 39.29	
Volatility	0.183	0.198	0.206	0.225	0.237	0.344	0.369	0.358	0.348	
Expected life (years)	5.0	10.0	9.0	8.0	7.0	6.0	5.0	5.0	5.0	
Assumed yield	5.75%	6.91%	5.93%	4.39%	4.09%	4.54%	4.23%	4.16%	4.61%	
Risk-free rate	3.57%	4.28%	5.11%	4.65%	3.49%	2.19%	2.17%	1.86%	0.78%	
Total value at grant date	\$ 66,600	\$ 71,100	\$ 143,400	\$ 285,300	\$ 254,700	\$ 222,950	\$ 287,950	\$ 297,375	\$ 244,388	\$ 1,873,763
Forfeited options	-	-	-	-	-	-	-	-	-	-
Expensed in previous years	66,600	71,100	143,400	285,300	254,700	222,950	-	-	-	1,044,050
Expensed in 2010	-	-	-	-	-	-	287,950	-	-	287,950
Expensed in 2011	-	-	-	-	-	-	-	297,375	-	297,375
Expensed in 2012	-	-	-	-	-	-	-	-	244,388	244,388
Future expense	-	-	-	-	-	-	-	-	-	-

STOCK OPTIONS ISSUED TO OFFICERS AND GRAND TOTALS									
Grant date	05/23/2003	04/26/2004	05/06/2005	04/27/2007	05/13/2011	5/4/2012	Subtotals	Grand Totals	
Total grant	220,000	122,500	132,500	135,000	162,500	242,500	1,015,000	1,297,500	
Vested	212,500	115,000	118,750	67,500	40,625	-	554,375	836,875	
Exercised	211,585	91,250	66,375	-	13,750	-	382,960	441,660	
Forfeited	7,500	7,500	13,750	67,500	41,250	130,000	267,500	285,000	
Exercisable at									
December 31, 2012	915	23,750	52,375	67,500	26,875	-	171,415	377,715	
Remaining unexercised	915	23,750	52,375	67,500	107,500	112,500	364,540	570,840	
Exercise price	\$ 24.91	\$ 25.78	\$ 33.22	\$ 54.17	\$ 41.82	\$ 39.29			
Volatility	0.175	0.183	0.207	0.233	0.330	0.315			
Expected life (years)	7.0	7.0	8.0	6.5	8.0	8.0			
Assumed yield	7.00%	5.75%	6.37%	4.13%	4.81%	5.28%			
Risk-free rate	4.00%	4.05%	4.15%	4.61%	2.75%	1.49%			
Total value at grant date	\$ 332,200	\$ 292,775	\$ 413,400	\$ 1,258,848	\$ 1,277,794	\$ 1,442,148	\$ 5,017,165	\$ 6,890,928	
Forfeited options	11,325	17,925	35,100	-	252,300	813,800	1,130,450	1,130,450	
Expensed in previous years	320,875	274,850	378,300	839,245	-	-	1,813,270	2,857,320	
Expensed in 2010	-	-	-	314,712	-	-	314,712	602,662	
Expensed in 2011	-	-	-	104,891	186,347	-	291,238	588,613	
Expensed in 2012	-	-	-	-	270,391	104,724	375,115	619,503	
Future expense	-	-	-	-	568,756	523,624	1,092,380	1,092,380	
Remaining weighted average term of future expense				2.9 years					

The table below summarizes the option activity for the years 2012, 2011, and 2010:

	2012		2011		2010	
	Shares	Wtd Avg Exercise Price	Shares	Wtd Avg Exercise Price	Shares	Wtd Avg Exercise Price
Outstanding at January 1	674,585	\$ 40.40	532,881	\$ 39.12	609,253	\$ 36.71
Granted	277,500	39.29	195,000	41.82	32,500	38.76
Exercised	(149,995)	31.03	(40,796)	29.03	(108,872)	25.52
Expired/Forfeited	(231,250)	43.56	(12,500)	45.05	—	—
Outstanding December 31	570,840	41.04	674,585	40.40	532,881	39.12
Exercisable at December 31	377,715	41.41	512,085	39.96	502,256	38.21

The intrinsic value of options exercised in 2012, 2011, and 2010, was \$1.6 million, \$688,000, and \$2.0 million, respectively. The intrinsic value of options outstanding and exercisable at year end 2012 was \$2.2 million and \$1.7 million, respectively. The intrinsic value measures the difference between the options' exercise price and the closing share price quoted by the New York Stock Exchange as of the date of measurement. The date of exercise was the measurement date for shares exercised during the period. At December 31, 2012, the final trading day of calendar 2012, the closing price of \$42.79 per share was used for the calculation of aggregate intrinsic value of options outstanding and exercisable at that date. Options having an exercise price in excess of the December 31, 2012 closing price have no intrinsic value. The weighted average remaining contractual life of the Company's exercisable and outstanding options at December 31, 2012 are 5.0 and 6.4 years, respectively.

11. NON-OPERATING ITEMS

Gain on casualty settlement in 2012 reflects insurance proceeds received in excess of the carrying value of assets damaged during a hail storm at French Market in 2012. Gain on casualty settlement in 2011 and 2010 reflects the excess of insurance proceeds over the carrying value of assets damaged during a severe hail storm at French Market. The insurance proceeds funded substantially all of the restoration of the damaged property.

12. 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. The aggregate fair value of the notes payable with fixed-rate payment terms was determined using Level 3 data in a discounted cash flow approach, which is based upon management's estimate of borrowing rates and loan terms currently available to the Company for fixed rate financing, and assuming long term interest rates of approximately 4.0% and 4.30%, would be approximately \$848.1 million and \$889.2 million, as of December 31, 2012 and 2011, respectively, compared

to the carrying value of \$774.8 million and \$808.8 million at December 31, 2012 and 2011, respectively. A change in any of the significant inputs may lead to a change in the Company's fair value measurement of its debt.

Effective June 30, 2011, the Company determined that one of its interest-rate swap arrangements was a highly effective hedge of the cash flows under one of its variable-rate mortgage loans and designated the swap as a cash flow hedge of that mortgage. The swap is carried at fair value with changes in fair value recognized either in income or comprehensive income depending on the effectiveness of the swap. The following chart summarizes the changes in fair value of the Company's swaps for the indicated periods.

(In thousands)	Year Ended December 31,		
	2012	2011	2010
Increase (decrease) in fair value:			
Recognized in earnings	\$ 36	\$ (1,332)	\$ —
Recognized in other comprehensive income	(932)	(3,195)	(543)
Total	\$ (896)	\$ (4,527)	\$ (543)

The Company carries its interest rate swaps 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. Derivative instruments are classified within Level 2 of the fair value hierarchy because their values are determined using third-party pricing models which contain inputs that are derived from observable market data. Where possible, the values produced by the pricing models are verified by the market prices. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit spreads, measure of volatility,

and correlations of such inputs. The swap agreements terminate on June 30, 2013 and July 1, 2020. As of December 31, 2012, the fair value of the interest-rate swaps was approximately \$5.9 million and is included in "Accounts payable, accrued expenses and other liabilities" in the consolidated balance sheets. The decrease in value from inception of the swap designated as a cash flow hedge is reflected in "Other Comprehensive Income" in the Consolidated Statements of Comprehensive Income.

13. 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.

14. DISTRIBUTIONS

In December 1995, the Company established a Dividend Reinvestment and Stock Purchase Plan (the "Plan"), to allow its stockholders and holders of limited partnership interests an opportunity to buy additional shares of common stock by reinvesting all or a portion of their dividends or distributions. The Plan provides for investing in newly issued shares of common stock at a 3% discount from market price without payment of any brokerage commissions, service charges or other expenses. All expenses of the Plan are paid by the Company. The Operating Partnership also maintains a similar dividend reinvestment plan that mirrors the Plan, which allows holders of limited partnership interests the opportunity to buy either additional limited partnership units or common stock shares of the Company.

The Company paid common stock distributions of \$1.44 per share, \$1.44 per share, and \$1.44 per share, during 2012, 2011, and 2010, respectively, and Series A preferred stock dividends of \$2.00 per depositary share and Series B preferred stock dividends of \$2.25 per share during each of the years in the period ended December 31, 2012. Of the common stock dividends paid, \$0.95 per share, \$0.72 per share, and \$1.008 per share, represented ordinary dividend income and \$0.49 per share, \$0.72 per share, and \$0.432 per share represented return of capital to the shareholders. All of the preferred stock dividends paid were considered ordinary dividend income.

The following summarizes distributions paid during the years ended December 31, 2012, 2011, and 2010, and includes activity in the Plan as well as limited partnership units issued from the reinvestment of unit distributions:

(In thousands)	Total Distributions to			Dividend Reinvestments	
	Preferred Stockholders	Common Stockholders	Limited Partnership Unitholders	Common Stock Shs Issued	Discounted Share Price
Distributions during 2012					
October 31	\$ 3,785	\$ 7,121	\$ 2,489	141,960	\$ 42.23
July 31	3,785	7,063	2,489	144,881	40.43
April 30	3,785	7,005	2,489	145,118	38.93
January 31	3,785	6,946	2,489	163,429	34.44
Total 2012	\$ 15,140	\$ 28,135	\$ 9,956	595,388	
Distributions during 2011					
October 31	\$ 3,785	\$ 6,867	\$ 2,489	160,589	\$ 34.82
July 31	3,785	6,772	1,950	125,973	38.30
April 30	3,785	6,730	1,950	111,592	42.49
January 31	3,785	6,693	1,950	100,094	45.92
Total 2011	\$ 15,140	\$ 27,062	\$ 8,339	498,248	
Distributions during 2010					
October 31	\$ 3,785	\$ 6,608	\$ 1,950	114,854	\$ 41.14
July 31	3,785	6,567	1,950	107,932	41.27
April 30	3,785	6,525	1,950	103,496	39.07
January 31	3,785	6,486	1,950	100,565	34.58
Total 2010	\$ 15,140	\$ 26,186	\$ 7,800	426,847	

In December 2012, the Board of Directors of the Company authorized a distribution of \$0.36 per common share payable in January 2013, to holders of record on January 17, 2013. As a result, \$7.2 million was paid to common shareholders on January 31, 2013. Also, \$2.5 million was paid to limited partnership unitholders on January 31, 2013 (\$0.36 per Operating Partnership unit). The Board of Directors authorized preferred stock dividends of \$0.50 per Series A depositary share, to holders of

record on January 7, 2013 and \$0.5625 per Series B depositary share to holders of record on January 7, 2013. As a result, \$3.8 million was paid to preferred shareholders on January 15, 2013. These amounts are reflected as a reduction of stockholders' equity in the case of common stock and preferred stock dividends and noncontrolling interest deductions in the case of limited partner distributions and are included in dividends and distributions payable in the accompanying consolidated financial statements.

15. INTERIM RESULTS (UNAUDITED)

The following summary presents the results of operations of the Company for the quarterly periods of calendar years 2012 and 2011.

<i>(In thousands, except per share amounts)</i>				
2012				
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenue	\$46,989	\$47,373	\$47,443	\$48,287
Operating income before loss on early extinguishment of debt, gain on casualty settlement, acquisition costs, discontinued operations and noncontrolling interest	9,318	9,598	8,160	9,149
Gain on sales of properties	–	–	–	4,510
Net income attributable to Saul Centers, Inc.	7,864	8,079	7,948	9,483
Net income available to common shareholders	4,079	4,294	4,163	5,698
Net income available to common shareholders per share (diluted)	0.21	0.22	0.21	0.29
2011				
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenue	\$41,608	\$42,666	\$42,756	\$46,848
Operating income before loss on early extinguishment of debt, gain on casualty settlement, acquisition costs, discontinued operations and noncontrolling interest	8,340	8,247	8,636	8,747
Net income attributable to Saul Centers, Inc.	7,309	6,398	5,504	7,522
Net income available to common shareholders	3,524	2,613	1,719	3,737
Net income available to common shareholders per share (diluted)	0.19	0.14	0.09	0.19

16. BUSINESS SEGMENTS

The Company has two reportable business segments: Shopping Centers and Mixed-Use 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 and cash flows from real estate for the combined properties in each segment. All of our properties within each segment generate similar types of revenues and expenses related to tenant rent, reimbursements and operating expenses. Although services are provided to a range of tenants, the types of services provided to them are similar within each segment. The properties in each portfolio have similar economic characteristics and the nature of the products and services provided to our tenants and the method to distribute such services are consistent throughout the portfolio. Certain reclassifications have been made to prior year information to conform to the 2012 presentation.

<i>(In thousands)</i>	Shopping Centers	Mixed-Use Properties	Corporate and Other	Consolidated Totals
As of or for the year ended December 31, 2012				
Real estate rental operations:				
Revenue	\$ 137,647	\$ 52,309	\$ 136	\$ 190,092
Expenses	(30,139)	(17,131)	–	(47,270)
Income from real estate	107,508	35,178	136	142,822
Interest expense and amortization of deferred debt costs	–	–	(49,544)	(49,544)
General and administrative	–	–	(14,274)	(14,274)
Subtotal	107,508	35,178	(63,682)	79,004
Depreciation and amortization of deferred leasing costs	(25,667)	(14,445)	–	(40,112)
Predevelopment expenses	–	(2,667)	–	(2,667)
Acquisition related costs	(1,129)	–	–	(1,129)
Change in fair value of derivatives	–	–	36	36
Gain on casualty settlement	219	–	–	219
Loss from operations of property sold	(81)	–	–	(81)
Gain on property dispositions	4,510	–	–	4,510
Net income	\$ 85,360	\$ 18,066	\$ (63,646)	\$ 39,780
Capital investment	\$ 46,353	\$ 8,290	\$ –	\$ 54,643
Total assets	\$ 894,027	\$ 301,355	\$ 11,927	\$ 1,207,309
As of or for the year ended December 31, 2011				
Real estate rental operations:				
Revenue	\$ 127,767	\$ 46,035	\$ 76	\$ 173,878
Expenses	(30,372)	(14,658)	–	(45,030)
Income from real estate	97,395	31,377	76	128,848
Interest expense and amortization of deferred debt costs	–	–	(45,324)	(45,324)
General and administrative	–	–	(14,256)	(14,256)
Subtotal	97,395	31,377	(59,504)	69,268
Depreciation and amortization of deferred leasing costs	(23,077)	(12,221)	–	(35,298)
Decrease in fair value of derivatives	–	–	(1,332)	(1,332)
Acquisition related costs	(2,534)	–	–	(2,534)
Loss from operations of property sold	(55)	–	–	(55)
Gain on casualty settlement	245	–	–	245
Net income	\$ 71,974	\$ 19,156	\$ (60,836)	\$ 30,294
Capital investment	\$ 177,958	\$ 24,546	\$ –	\$ 202,504
Total assets	\$ 871,409	\$ 308,053	\$ 13,107	\$ 1,192,569

16. BUSINESS SEGMENTS (CONTINUED)

<i>(In thousands)</i>	Shopping Centers	Mixed-Use Properties	Corporate and Other	Consolidated Totals
As of or for the year ended December 31, 2010				
Real estate rental operations:				
Revenue	\$ 125,015	\$ 38,060	\$ 33	\$ 163,108
Expenses	(29,923)	(12,052)	-	(41,975)
Income from real estate	95,092	26,008	33	121,133
Interest expense and amortization of deferred debt costs	-	-	(34,799)	(34,799)
General and administrative	-	-	(13,968)	(13,968)
Subtotal	95,092	26,008	(48,734)	72,366
Depreciation and amortization of deferred leasing costs	(20,491)	(7,888)	-	(28,379)
Loss on early extinguishment of debt	-	-	(5,405)	(5,405)
Acquisition related costs	(1,179)	-	-	(1,179)
Gain on casualty settlement	2,475	-	-	2,475
Loss from operations of property sold	(284)	-	-	(284)
Gain on property sale	3,591	-	-	3,591
Net income	\$ 79,204	\$ 18,120	\$ (54,139)	\$ 43,185
Capital investment	\$ 29,253	\$ 68,986	\$ -	\$ 98,239
Total assets	\$ 704,624	\$ 294,791	\$ 14,473	\$ 1,013,888

17. SUBSEQUENT EVENTS

On January 31, 2013, the Company issued a notice to redeem 60% of the depositary shares related to the 8% Series A Cumulative Redeemable Preferred Stock at a price of \$25.00 per depositary share, plus accrued dividends. The depositary shares were redeemed pro-rata on March 2, 2013.

On February 12, 2013, the Company sold, in an underwritten public offering, 5.6 million depositary shares, each representing 1/100th of a share of 6.875% Series C Cumulative Redeemable Preferred Stock, providing net cash proceeds of approximately \$134.8 million. The depositary shares may be redeemed at the Company's option, in whole or in part, at the \$25.00 liquidation preference plus accrued but unpaid dividends on or after February 12, 2018. The depositary shares pay an annual dividend of \$1.71875 per share, equivalent to 6.875% of the \$25.00 liquidation preference. The first dividend is scheduled to be paid on April 15, 2013 and covers the period from February 12, 2013 through March 31, 2013. The Series C 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 except in connection with certain changes of control or delisting events. 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.

On February 12, 2013, the Company issued a notice to redeem all of the outstanding depositary shares related to the 9% Series B Cumulative Redeemable Preferred Stock at a price of \$25.00 per depositary share, plus accrued dividends. The redemption date is March 15, 2013.

On February 27, 2013, the Company closed on a three-year \$15.6 million mortgage loan secured by Metro Pike Center. The loan matures in 2016, bears interest at a variable rate equal to the sum of one-month LIBOR and 165 basis points, requires monthly principal and interest payments based on a 25-year amortization schedule and a final payment of \$14.7 million at maturity. The loan may be extended for up to two-years. Proceeds were used to pay-off the \$15.9 million remaining balance of existing debt secured by Metro Pike Center, and to extinguish the related swap agreement, which were scheduled to mature in June 2013.

On February 27, 2013, the Company closed on a three-year \$15.0 million mortgage loan secured by Northrock. The loan matures in 2016, bears interest at a variable rate equal to the sum of one-month LIBOR and 165 basis points, requires monthly principal and interest payments based on a 25-year amortization schedule and a final payment of \$14.2 million at maturity. The loan may be extended for up to two years. Proceeds were used to pay-off the \$15.0 million remaining balance of existing debt secured by Northrock, which was scheduled to mature in May 2013.

The Company recently completed negotiation of lease termination agreements with the tenants of Van Ness Square and expects the building will be vacant on or about April 30, 2013. Costs incurred related to those termination arrangements are being amortized to expense using the straight-line method over the remaining terms of the leases. In addition, the remaining lives of (a) straight line rent recognition and (b) the building, have been adjusted to end on April 30, 2013.

DIVIDEND REINVESTMENT PLAN

Saul Centers, Inc. offers a dividend reinvestment plan which enables its shareholders to automatically invest some of or all dividends in additional shares. The plan provides shareholders with a convenient and cost-free way to increase their investment in Saul Centers. Shares purchased under the dividend reinvestment plan are issued at a 3% discount from the average price of the stock on the dividend payment date. The Plan's prospectus is available for review in the Shareholders Information section of the Company's web site.

To receive more information please call the plan administrator at (800) 509-5586 and request to speak with a service representative or write:

Continental Stock Transfer and Trust Company
 Attention: Saul Centers, Inc.
 Dividend Reinvestment Plan
 17 Battery Place
 New York, NY 10004

DIVIDENDS AND DISTRIBUTIONS

Under the Code, REITs are subject to numerous organizational and operating requirements, including the requirement to distribute at least 90% of REIT taxable income. The Company distributed amounts greater than the required amount in 2012 and 2011. Distributions by the Company to common stockholders and holders of limited partnership units in the Operating Partnership were \$38.1 million and \$35.4 million in 2012 and 2011, respectively. Distributions to preferred stockholders were \$15.1 million in both 2012 and 2011. See Notes to Consolidated Financial Statements, No. 14, "Distributions." The Company may or may not elect to distribute in excess of 90% of REIT taxable income in future years.

The Company's estimate of cash flow available for distributions is believed to be based on reasonable assumptions and represents a reasonable basis for setting distributions. However, the actual results of operations of the Company will be affected by a variety of factors, including but not limited to actual rental revenue, operating expenses of the Company, interest expense, general economic conditions, federal, state and local taxes (if any),

unanticipated capital expenditures, the adequacy of reserves and preferred dividends. While the Company intends to continue paying regular quarterly distributions, any future payments will be determined solely by the Board of Directors and will depend on a number of factors, including cash flow of the Company, its financial condition and capital requirements, the annual distribution amounts required to maintain its status as a REIT under the Code, and such other factors as the Board of Directors deems relevant. We are obligated to pay regular quarterly distributions to holders of depositary shares of Series A preferred stock, 60% of which was redeemed on March 2, 2013, at the rate of \$2.00 per annum per depositary share, to holders of depositary shares of Series B preferred stock at the rate of \$2.25 per annum per depositary share through its March 15, 2013 redemption, and to holders of depositary shares of Series C preferred stock at the rate of \$1.71875 per annum per depositary share beginning February 12, 2013, prior to distributions on the common stock.

The Company paid four quarterly distributions totaling \$1.44 per common share during each of the years in the three-year period ended December 31, 2012. The annual distribution amounts paid by the Company exceed the distribution amounts required for tax purposes. Distributions to the extent of our current and accumulated earnings and profits for federal income tax purposes generally will be taxable to a stockholder as ordinary dividend income. Distributions in excess of current and accumulated earnings and profits will be treated as a nontaxable reduction of the stockholder's basis in such stockholder's shares, to the extent thereof, and thereafter as taxable gain. Distributions that are treated as a reduction of the stockholder's basis in its shares will have the effect of deferring taxation until the sale of the stockholder's shares. Of the \$1.44 per common share dividend paid in 2012, 66% was treated as a taxable dividend and 34% was treated as a return of capital. Of the \$1.44 per common share dividend paid in 2011, 50% was treated as a taxable dividend and 50% was treated as a return of capital. Of the \$1.44 per common share dividend paid in 2010, 70.0% was taxable dividend income and 30.0% was considered return of capital. No assurance can be given regarding what portion, if any, of distributions in 2013 or subsequent years will constitute a return of capital for federal income tax purposes. All of the preferred stock dividends paid are treated as ordinary dividend income.

Shares of Saul Centers common stock are listed on the New York Stock Exchange under the symbol "BFS". The composite high and low closing sale prices for the shares of common stock were reported by the New York Stock Exchange for each quarter of 2012 and 2011 as follows:

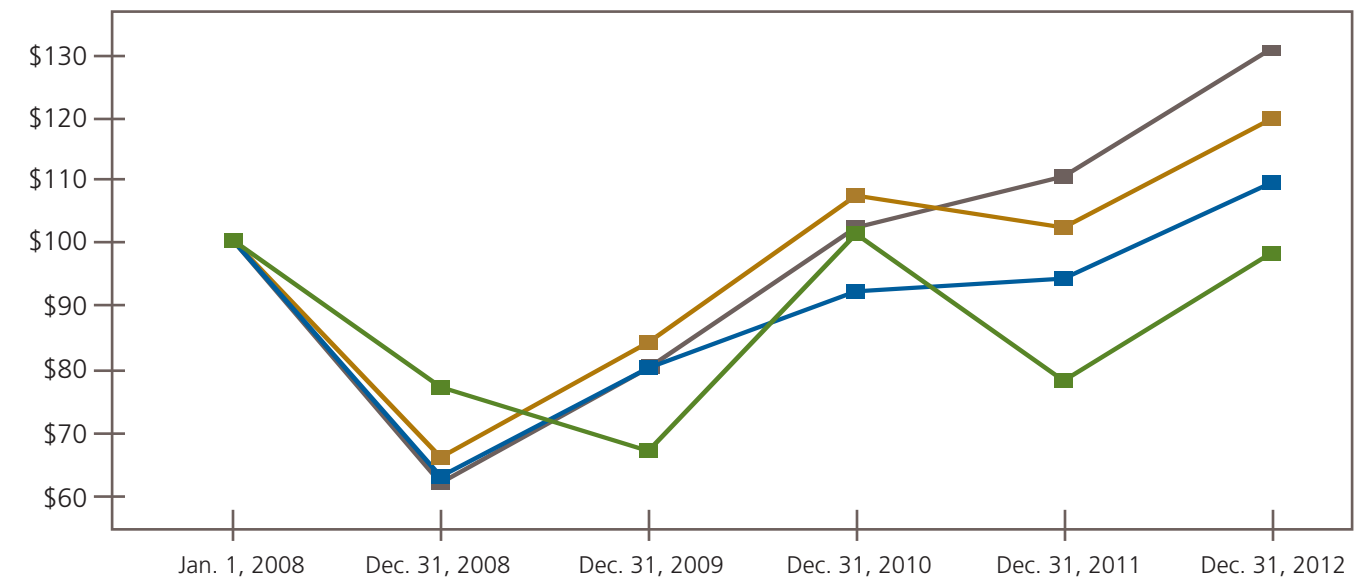
COMMON STOCK PRICES		
Period	Share Price	
	High	Low
October 1, 2012 – December 31, 2012	\$45.34	\$40.81
July 1, 2012 – September 30, 2012	\$45.83	\$40.59
April 1, 2012 – June 30, 2012	\$43.32	\$39.01
January 1, 2012 – March 31, 2012	\$40.62	\$33.44
<hr/>		
October 1, 2011 – December 31, 2011	\$36.66	\$32.26
July 1, 2011 – September 30, 2011	\$41.72	\$31.54
April 1, 2011 – June 30, 2011	\$44.29	\$37.16
January 1, 2011 – March 31, 2011	\$48.40	\$42.30

On March 1, 2013, the closing price was \$44.34 per share.
 The approximate number of holders of record of the common stock was 220 as of March 1, 2013.

PERFORMANCE GRAPH

Rules promulgated under the Exchange Act require the Company to present a graph comparing the cumulative total stockholder return on its Common Stock with the cumulative total stockholder return of (i) a broad equity market index, and (ii) a published industry index or peer group. The following graph compares the cumulative total stockholder return of the Company's common stock, based on the market price of the common stock and assuming reinvestment of dividends, with the National Association of Real Estate Investment Trust Equity Index ("NAREIT Equity"), the S&P 500 Index ("S&P 500") and the Russell 2000 Index ("Russell 2000"). The graph assumes the investment of \$100 on January 1, 2008.

COMPARISON OF CUMULATIVE TOTAL RETURN



	Jan. 1, 2008	Dec. 31, 2008	Dec. 31, 2009	Dec. 31, 2010	Dec. 31, 2011	Dec. 31, 2012
Saul Centers	\$100	\$77	\$67	\$101	\$78	\$98
S&P 500	\$100	\$63	\$80	\$92	\$94	\$109
Russell 2000	\$100	\$66	\$84	\$107	\$102	\$119
NAREIT Equity	\$100	\$62	\$80	\$102	\$110	\$130

DIRECTORS

B. Francis Saul II
Chairman and Chief
Executive Officer

Thomas H. McCormick
President and Chief Operating Officer

Philip D. Caraci
Vice Chairman

**The Honorable
John E. Chapoton**
Partner, Brown Investment Advisory

George P. Clancy, Jr.
Executive Vice President, Emeritus
Chevy Chase Bank

Gilbert M. Grosvenor
Chairman Emeritus of
the Board of Trustees,
National Geographic Society

Philip C. Jackson, Jr.
Adjunct Professor Emeritus,
Birmingham-Southern College

General Paul X. Kelley
28th Commandant of
the Marine Corps

Charles R. Longworth
Chairman Emeritus, Colonial
Williamsburg Foundation

Patrick F. Noonan
Chairman Emeritus,
The Conservation Fund

H. Gregory Platts
Senior Vice President and
Treasurer, Emeritus,
National Geographic Society

Mark Sullivan III
Financial and Legal Consultant

**The Honorable
James W. Symington**
Of Counsel, O'Connor and Hannan,
Attorneys at Law

John R. Whitmore
Financial Consultant

EXECUTIVE OFFICERS

B. Francis Saul II
Chairman and Chief
Executive Officer

Thomas H. McCormick
President and Chief Operating Officer

J. Page Lansdale
Executive Vice President,
Real Estate

Scott V. Schneider
Senior Vice President,
Chief Financial Officer,
Treasurer and Secretary

Debra Stencil
Senior Vice President and
General Counsel

Joel A. Friedman
Senior Vice President,
Chief Accounting Officer

Christopher H. Netter
Senior Vice President, Leasing

John F. Collich
Senior Vice President,
Acquisitions and Development

Charles W. Sherren, Jr.
Senior Vice President, Management

COUNSEL

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Shaw Pittman LLP
Washington, DC 20037

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Ernst and Young LLP
McLean, Virginia 22102

WEB SITE

www.saulcenters.com

EXCHANGE LISTING

New York Stock
Exchange (NYSE) Symbol:
Common Stock: BFS
Preferred Stock: BFS.PrA
BFS.PrC

TRANSFER AGENT

Continental Stock Transfer and
Trust Company
17 Battery Place
New York, NY 10004
(800) 509-5586

INVESTOR RELATIONS

A copy of the Saul Centers, Inc. annual report to the Securities and Exchange Commission on Form 10-K, which includes as exhibits the Chief Executive Officer and Chief Financial Officer Certifications required by Section 302 of the Sarbanes-Oxley Act, may be printed from the Company's web site or obtained at no cost to stockholders by writing to the address below or calling (301) 986-6016. In 2012, the Company filed with the NYSE the Certification of its Chief Executive Officer confirming that he was not aware of any violation by the Company of the NYSE's corporate governance listing standards.

HEADQUARTERS

7501 Wisconsin Ave.
Suite 1500E
Bethesda, MD 20814-6522
Phone: (301) 986-6200



Annual Meeting of Shareholders

The Annual Meeting of Shareholders will be held at 11:00 a.m., local time, on May 10, 2013, at the Hyatt Regency Bethesda, One Bethesda Metro Center, Bethesda, MD (at the southwest corner of the Wisconsin Avenue and Old Georgetown Road intersection, adjacent to the Bethesda Metro Stop on the Metro Red Line.)



Saul Centers

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